

***United States Court of Appeals
for the Second Circuit***



**SUPPLEMENTAL
APPENDIX**

No. 74-1697

United States Court of Appeals For the Second Circuit

SIRBO HOLDINGS, INC.,
PETITIONER, APPELLANT,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT, APPELLEE.

B

ON APPEAL FROM THE UNITED STATES TAX COURT

APPELLANT'S SUPPLEMENTAL RECORD APPENDIX

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TAX COURT OF THE UNITED STATES

GENERAL DOCKET

515-69

DOCKET NO. _____

CLASS _____

IRBO HOLDINGS, INC.
 (Morton Shainess, President.)
 4 West 54th Street,
 New York, New York.

PETITIONER.

VS.

SIONER OF INTERNAL REVENUE,

RESPONDENT.

APPEARANCES FOR PETITIONER:

NAME *Lester H. Salter, James R. McGowan, -(Salter
-and-McGowan), -146 Westminister Street,
Providence, Rhode Island 02903.

ADDRESS *(Salter, McGowan, Arcaro & Swartz)
300 Industrial Bank Building

Date Month Day Year	Filings and Proceedings	Action	Served
Feb. 5, 1969	PETITION FILED: FEE PAID Feb. 5, 1969.		Feb. 6, 1969
Apr. 1, 1969	REQUEST by resp. for trial at New York, N.Y.	GRANTED Apr. 2, 1969	APR 2 1969
Apr. 1, 1969	ANSWER filed by respondent.		APR 2 1969
Nov. 12, 1970	NOTICE OF TRIAL at New York, New York on Jan. 25, 1971.		Nov. 12, 1970
Jan. 4, 1971	MOTION by Petr. for continuance from New York, N.Y., Jan. 25, 1971	DENIED Jan. 5, 1971	Jan. 5, 1971
Feb. 3, 1971	TRIAL at New York, N. Y. before Judge Quealy. Stipulation of Facts filed. Supplemental Stipulation of Facts filed. ORIGINAL BRIEFS DUE - March 29, 1971 REPLY BRIEFS DUE - April 26, 1971 SUBMITTED TO JUDGE QUEALY		
Feb. 18, 1971	TRANSCRIPT of Trial of Feb. 3, 1971 received. (2 Vol.)		
Apr. 29, 1971	MOTION by Petr. to extend time to file Brief to April 16, 1971.	GRANTED Apr. 1, 1971	April 2, 1971
Apr. 29, 1971	BRIEF for Respondent filed.		April 19, 1971
Apr. 16, 1971	BRIEF for Petitioner filed		April 19, 1971

(Continued on page 2)

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Form No. 34
March 1957

TAX COURT OF THE UNITED STATES

515-69 GENERAL DOCKET

DOCKET NO. _____

(Continuation)

SIRBO HOLDINGS INC.		JUDGE QUEALY	PETITIONER	PAGE 2
Date	Filings and Proceedings	Action	Served	
Month Day Year				
May 11, 1971	REPLY BRIEF for Petitioner filed			
May 12, 1971	MOTION by Resp. to extend time to June 14, 1971 within which to file Reply brief.	GRANTED May 14, 1971	May 14, 1971	
June 14, 1971	REPLY BRIEF for Respondent filed		June 17, 1971	
Jan 27, 1972	FINDINGS OF FACT & OPINION filed Judge Quealy		Jan. 27, 1972	
	(Decision will be entered for respondent)			
Feb. 7, 1972	DECISION entered Judge Quealy		Feb. 7, 1972	
Apr. 17, 1972	MOTION by Petr. for leave to file Motion for reconsideration of opinion filed. (Motion for reconsideration of Opinion Lodged)	DENIED Apr. 18, 1972	Apr. 20, 1972	
Apr. 17, 1972	MOTION by Petr. for leave to file Motion to vacate Decision filed. (Motion to vacate decision Lodged)	DENIED Apr. 18, 1972	Apr. 20, 1972	
	APPELLATE PROCEEDINGS			
May 3, 1972	NOTICE OF APPEAL to U.S.C.A., 2nd Cir., filed by Petr.		May 5, 1972	
May 5, 1972	NOTICE OF FILING with copy of Notice of Appeal served on Mr. Lee H. Henkel, Jr., Acting Chief Counsel.		May 5, 1972	
May 5, 1972	NOTICE to parties of assembling and date for transmission of the record.		May 5, 1972	
June 2, 1972	RECORD ON APPEAL mailed to Clerk, U.S.C.A., 2nd Cir.			
Apr. 30, 1973	Certified copy of Judgment, in lieu of Mandate, the decision of the Tax Court is vacated and the case is remanded to the Court for further proceedings under the mandate.			
July 31, 1973	ORDERED: further proceedings as may be required pursuant to the mandate of the U.S.C.A. for 2nd Circuit			JUL 31 1973
		continued to	page 3	

UNITED STATES TAX COURT

GENERAL DOCKET

DOCKET NO. 515-69

(Continuation)

SIRBO HOLDING, INC.			PETITIONER	PAGE 3
Date	Filings and Proceedings	Quealy	Action	Served
Month Day Year				
Order 7/31/73 (continued).	shall be held on Aug. 15, 1973 Washington, D.C. Judge Quealy.			
Aug. 13, 1973	ORDER, that the case is stricken from Aug. 15, 1973 and further			AUG 14 1973
	ORDER, that within 30 days from the date hereof			
	counsel for resp. shall file for the record			
	in this case, the record and briefs in the			
	case of <u>Boston Fish Market Corp.</u> , and further			
	ORDER, that resp. shall be allowed a period			
	of 45 days from the date of such filing			
	within which to submit a brief or memorandum			
	and counsel for the Petr. shall be allowed			
	30 days thereafter within which to submit			
	any opposing briefs or memorandum.			
Oct. 12, 1973	STIPULATION re: Certified Copy of Tax Court Record/in Dkt. No. 6054-70 and Joint Exhibits 1-A through 15-0 are copies of Original Exhibits entered in Dkt. No. 6054-70. (Attached).	and Brief		
Nov. 24, 1973	MOTION by Resp. to extend time to Nov. 28, 1973 within which to file brief.			
Nov. 28, 1973	BRIEF for Resp on Remand.			
Dec. 10, 1973	MOTION by Petr. for extension of time to January 28, 1974 within which to file Brief.			
Jan. 28, 1974	PETITIONER'S BRIEF in Reply to Brief for Respondent on Remand filed.			

GRANTED
Oct. 25, 1973 OCT 29 1973
NOV 29 1973

GRANTED
Dec. 10, 1973 DEC 11 1973

JAN 28 1974

GPO : 1973-O-496-9/9

(Continued to Page 4)

(Continuation)

Form No. 34A
March 1957

476 F.2d 981

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 167—September Term, 1972.

(Argued November 6, 1972 Decided March 23, 1973.)

Docket No. 72-1617

SIRBO HOLDINGS, INC.,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before:

FRIENDLY, *Chief Judge,*
MANSFIELD and TIMBERS, *Circuit Judges.*

Appeal from a judgment of the United States Tax Court, William H. Quealy, *Judge*, 57 T.C. No. 55 (1972), upholding the Commissioner's assessment of a deficiency in the Federal income tax of the petitioner in the amount of \$53,573.30 for the taxable year ended June 30, 1964.

Vacated and remanded.

JAMES R. MCGOWAN, Esq., Providence, R.I.
(Lester H. Salter, Esq., Salter, McGowan,
Arcaro & Swartz, Providence, R.I., of
Counsel), *for Petitioner-Appellant.*

MARY J. MCGINN, Attorney, Department of Justice, Washington, D.C. (Scott P. Crampton, Assistant Attorney General, Meyer Rothwacks, Ernest J. Brown, Attorneys, Tax Division, Department of Justice, Washington, D.C., of Counsel), for Respondent-Appellee.

FRIENDLY, Chief Judge:

The issue is whether a tenant's payment to its landlord of \$125,000 in satisfaction of the tenant's obligation to restore leased premises to their pre-lease condition is entitled, in whole or in part, to long-term capital gains treatment under § 1231 of the Internal Revenue Code of 1954.¹ The Commissioner determined the payment, which

¹ For the taxable year involved in this appeal, 26 I.R.C. § 1231 provided in relevant part:

§ 1231. *Property used in the trade or business and involuntary conversions*

(a) General rule.—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than six months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six months. . . .

.

(b) Definition of property used in the trade or business.—For purposes of this section—

(1) General rule.—The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not—

was received by petitioner, Sirbo Holdings, Inc. ("Sirbo") from its tenant, to be taxable as ordinary income, and accordingly found a deficiency in petitioner's income tax for the taxable year ending June 30, 1964, which was upheld by the Tax Court. Petitioner then sought review pursuant to 26 U.S.C. § 7482.

The essential facts are undisputed: At all relevant times Sirbo was engaged in the trade or business of renting real estate. In 1944 it purchased premises at 254-6 West 54th Street, New York, N.Y., which consisted of a building with offices and a theatre called The New Yorker Theatre, subject to an existing lease of the theatre to the Columbia Broadcasting System, Inc. ("CBS"), which used it for radio broadcasting purposes. In July, 1944, Sirbo notified CBS that it had purchased the entire building and would assume all the terms and obligations of the theatre lease. In anticipation of the expiration of the existing lease term in 1948, Sirbo in November, 1947, negotiated a new lease of the theatre to CBS. Thereafter Sirbo continuously rented the theatre to CBS under several successive leases until at least December 31, 1968. Each lease gave CBS the "right to use the premises as a theatre, and for radio broadcasting and television purposes of its business." Until 1964 each lease provided that at the expiration of the lease term CBS "shall restore the premises substantially to the condition in which they existed on November 14, 1947, reasonable wear and tear and damage by the ele-

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

(C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in paragraph (3) of section 1221. . . .

ments excepted, and . . . shall fully indemnify [Sirbo] for every and all costs and expenses of whatsoever name or nature that may be required for the purposes of reinstating the premises to said condition."²

Prior to December 31, 1963, according to findings of the Tax Court,³ CBS, becoming concerned over rising construction costs which made it difficult to predict its ultimate cost of fulfilling its obligations to restore premises leased by it, determined as a matter of corporate policy to eliminate or update restoration clauses from leases it held for theatres in New York and so advised Sirbo. The parties negotiated the terms of the 1964 lease, including an "updated" restoration clause which limited CBS' ter-

² The full leasehold obligation contained in the indenture covering the period July 15, 1958 through December 31, 1963, which is the subject of the payment in issue in this case, provides:

FOURTH:—At the expiration or other termination of the term hereby granted, the TENANT shall and will leave the said premises and the theatre whole and in good order and condition and will remove therefrom every and all its equipment, goods, and effects, and those of all persons claiming under it, and will deliver up the demised premises in good order and condition, reasonable wear and tear and damage by the elements excepted, it being understood that all scenery therein, stage hangings, properties, decorations and equipment, including but not limited to radio and/or audio equipment, and its associated equipment, installed and paid for by the TENANT, which may be affixed to or contained in the herein demised premises may be removed by the TENANT whether the same constitutes fixtures or not, provided, however, that the TENANT shall restore the premises substantially to the condition in which they existed on November 14, 1947, reasonable wear and tear and damage by the elements excepted, and the TENANT shall fully indemnify the LANDLORD for every and all costs and expenses of whatsoever name or nature that may be required for the purposes of reinstating the premises to said condition. TENANT agrees to restore any and all seats heretofore removed by TENANT, to remove the control booths installed by TENANT and to remove the extension of the stage apron installed by TENANT.

The prior instruments contained essentially the same provision.

³ The Tax Court's findings of fact are published in *Sirbo Holdings, Inc.*, 57 T.C. No. 55 (January 27, 1972).

minimal obligation to restore the theatre to removal of alterations or additions made after January 1, 1964, and repair of any damage caused thereby. Thereupon they entered into separate negotiations for settlement of CBS' obligation under the former lease to restore the theatre to its 1947 condition. Each party caused appraisals of the cost of restoration to be made. Estimates of \$70,000 and \$200,000 were made by representatives of CBS and Sirbo, respectively, and the sum of \$125,000 was agreed upon as a compromise figure. The sizable cost estimates reflected the changes CBS had made after 1947 to adapt the former legitimate theatre for use as a television studio. As found by the Tax Court, these "changes included the removal of approximately 300 to 400 theatre seats, . . . all carpeting, chandeliers, and stage curtains; the extension of the stage area . . . , a change in the floor level and the elimination of the 'loop' in the former seating arrangement, the construction of walls and partitions and appropriate structural changes to accommodate control rooms, the alteration of bathrooms and the heating system, and the installation of thousands of feet of electrical wiring." The restoration clauses contained in the leases covering the period from 1953-1964 implicitly recognized the alterations made by CBS by providing for the eventual replacement of the removed seats, the removal of the control booths, and the removal of the extension of the stage apron.⁴

In a settlement signed on January 31, 1964 but backdated to December 31, 1963, CBS paid Sirbo the \$125,000 sum for the release of any claims, injury or damage Sirbo might have as a result of the provisions of the restoration clause contained in the lease dated July 15, 1958. The release stated that Sirbo had claimed at the expiration of the lease term that CBS had partially destroyed the prem-

⁴ See note 2 *supra*.

ises and Sirbo therefore requested indemnification for the cost of reinstating the premises to their condition in 1947; CBS acknowledged its obligation so to indemnify Sirbo.⁵ No portion of the payment was used to restore the structure to its former use as a legitimate theatre, however, since CBS continued in occupancy. Indeed, the Tax Court found that, after entering into the 1964 lease, CBS made further modifications in the theatre to adapt it for use as a color television studio.

On its corporate tax return for its taxable year ending June 30, 1964, Sirbo reported as long-term capital gain resulting from "involuntary conversion as a result of partial destruction of property used in trade or business," the amount by which the \$125,000 received from CBS exceeded Sirbo's adjusted basis in the entire property, \$93,333.51 (including the leased theatre as a part), i.e., \$31,666.49.⁶ The Commissioner determined that the \$125,000 payment from CBS was taxable as ordinary income rather than as long-term capital gain and accordingly noted a deficiency in Sirbo's tax liability for the taxable year in question. Sirbo's ordinary income was increased by that

5 In addition, for nominal consideration, the parties mutually executed general releases from any liability arising out of the 1958 lease. In the release dated December 23, 1963, CBS also discharged Sirbo from any liability arising from the use and occupancy of its premises by CBS, and in the release dated January 31, 1964, Sirbo discharged CBS from any liability arising out of the "use, occupancy, alteration, addition, removal, or improvement" of the premises by CBS. Both general releases were to be held in escrow pending execution of the new lease which was to be simultaneous with the first installment of the payment by CBS for the "purchase" of the theatre equipment. A separate letter casting the \$125,000 payment by CBS in the form of the purchase price of personal property and theatre equipment owned by Sirbo, but not yet inventoried, was apparently never signed.

6 The Tax Court found that Sirbo had never apportioned the basis of the building between the theatre and the offices which make up the remainder, but that the adjusted basis for the whole building (cost basis of \$266,666.67 less accumulated depreciation to 1964 of \$173,333.16) was \$93,333.51.

amount and capital gain was decreased by \$31,666.49, resulting in a net deficiency in income tax of \$53,573.30. Sirbo was allowed additional depreciation for the year in issue in the amount of \$4,444.44, however, which had not been taken because the taxpayer had claimed an involuntary conversion of the property.

The government does not dispute that the property to which the release of the obligation to restore related was "property used in [Sirbo's] trade or business" within the meaning of § 1231. It denies, however, that the \$125,000 payment constituted either gain on its compulsory or involuntary conversion, or from its sale or exchange. Insofar as petitioner rested its claim to capital gains treatment on the involuntary conversion clause of § 1231, we agree with the Tax Court that it failed. The New Yorker Theatre was voluntarily leased to CBS with the understanding that it might be converted for use as a television studio. When CBS sought to be released from its obligations to restore the theatre to its 1947 condition and to indemnify Sirbo for the cost of doing so, Sirbo voluntarily agreed to accept a cash payment rather than enforce these obligations. This was understandable from Sirbo's vantage point, since CBS wanted to continue to occupy the converted theatre and use it as a television studio at a substantial rental. But the decision to accept the \$125,000 rather than hold CBS to its obligation to restore was not "compulsory or involuntary." It is not claimed that it resulted from duress or some external force over which Sirbo had no control, such as occurs when property is destroyed by natural causes, is stolen or seized, or is transferred under power or threat of eminent domain.

The cases relied upon by petitioner on this point are distinguishable. In *Guy L. Waggoner*, 15 T.C. 496 (1950), the taxpayers leased property to the United States under

threat of condemnation. The lease gave the government a qualified right to alter the premises, but provided for restoration at the taxpayers' request. When the taxpayers subsequently requested restoration, the United States decided to pay the cost of repair for damage it had caused while in possession rather than itself restore the premises. Thus, as the Tax Court held, the property altered or destroyed was involuntarily converted into money within the meaning of the predecessor to § 1231, and the taxpayers' acceptance of compensation for the property in lieu of actual restoration "did not alter the character of the lease agreement." 15 T.C. at 503. See also *C.I.R. v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 135-36 (1960). Sirbo, however, was neither forced to lease the premises to CBS nor compelled to accept the payment instead of requiring renovation. The settlement it reached with its tenant did not arise from an occupancy imposed upon it pursuant to law, but from an occupancy it sought as part of its normal business operations. Unlike the taxpayers in *Guy L. Waggoner, supra*, it could choose whether it would lease its premises, the identity of the person to whom it might lease them, and the conditions of occupancy.

Similarly, in *Walter A. Henshaw*, 23 T.C. 176 (1954), and *United States v. Pate*, 254 F.2d 480 (10 Cir. 1958), the property of the taxpayer used in the trade or business (oil in place in *Henshaw*, a building in *Pate*) was physically damaged under circumstances beyond the taxpayer's control, namely through the negligence of others. In both cases the taxpayer recovered monetary damages as a result of litigation, and the sums were taxed as long-term capital gains from the compulsory or involuntary conversion of the damaged property. Here the structural modifications needed to convert the theatre to a television studio were contemplated as a distinct possibility under the lease

agreement and were essentially made with Sirbo's consent, subject to the obligation to restore.

Relying on *Grant Oil Tool Co. v. United States*, 381 F.2d 389 (Ct. Cl. 1967), Sirbo urges that prior contemplation of alterations in the leased structure does not deprive the lessee's conversion of its involuntary character, even when the lease agreement provides for restoration or compensation to the lessor. We disagree. *Grant Oil Tool Co.* differs in a crucial respect. There the taxpayer could not have had restoration of the destroyed property, whereas Sirbo could. In that case a manufacturer leased oil well drilling tools to drillers for use in their business, subject to loss in the drill hole, misplacement, or damage beyond repair due to the driller's negligence in use. The decision to abandon or try to retrieve the tools lost in the drill hole was found to be exclusively that of the driller-lessee, who was obligated in either event to reimburse the lessor at the sale price of new equipment. These payments were held to be entitled to capital gains treatment pursuant to § 1231(a) as a "compulsory or involuntary conversion," for the reason that the "complete and unwanted destruction of [the] taxpayer's tool bodies" which brought it "within the definition of 'involuntary conversion' as set forth in § 1231(a)," *id.* at 395-96, was beyond the taxpayer's control once its property was leased. As far as the lessor was concerned the property destroyed in the lessee's operations was irretrievably lost without opportunity of restoration or recovery. See also *Philadelphia Quartz Co. v. United States*, 374 F.2d 512 (Ct. Cl. 1967). In contrast, not only did Sirbo have the power to fashion the lease agreement to prevent CBS from making the extensive alterations which were the subject of the payment, but it had the right to pursue the possible avenue of requiring CBS to restore the property to its former condition and voluntarily chose not to do so.

While involuntary conversion was the ground most strongly argued by Sirbo, it contended in the alternative that the transaction constituted the sale or exchange of property used in the trade or business. Judge Quealy rejected that contention, largely on the basis of extensive dicta in this court's decision in *Billy Rose's Diamond Horseshoe, Inc. v. United States*, 448 F.2d 549, 551-52 (2 Cir.), *aff'g* 322 F. Supp. 76 (S.D.N.Y. 1971). In their holding that a landlord receiving a series of notes in satisfaction of an obligation to restore was not entitled to the benefits of the installment sales provision of I.R.C. § 453(a), the court noted that the landlord's relinquishment of its rights to have the property restored caused these rights to have come "to an end and vanished" and thus could not constitute a "sale or other disposition of real property" under § 453(b)(1)(A). At least as applied to the question of capital gains treatment under § 1231, this seems to be taking somewhat of a keyhole view. Sirbo's claim for capital gains treatment does not rest entirely on the release of the covenant to restore, which clearly was not "property used in the trade or business," but it is based at least in part on CBS' payment for removal or destruction of "property" such as the theatre seats, carpeting, chandeliers, stage curtains and various structural features of the theatre. Realistically CBS was paying Sirbo for what it had done to this property over the years. Under our decision in *C.I.R. v. Ferrer*, 304 F.2d 125, 131 (2 Cir. 1962), see Eustice, Contract Rights, Capital Gain and Assessment of Income—the Ferrer Case, 20 Tax L. Rev. 1, 7-34 (1964), it would not be fatal that this property did not "pass" to CBS. If the lease, in lieu of an obligation to restore, had obligated CBS from the outset to pay for the property to be removed or damaged by it, there could be little question but that the payment would be viewed as a sale or exchange of property used in the trade or

business, see *Hamilton & Main Inc.*, 25 T.C. 878 (1956); *Washington Fireproof Building Co.*, 31 B.T.A. 824 (1934), since the government does not contend that such a payment would represent "collapsed income." See, e.g., *Hort v. C.I.R.*, 313 U.S. 28 (1941); *Holt v. C.I.R.*, 303 F.2d 687 (9 Cir. 1962); *W. Lawrence Oliver*, 24 T.C.M. 438 (1965). From a practical standpoint it is hard to see why the transaction here at issue should be treated differently. Classification of CBS's payment as ordinary income merely because of the parties' failure to cast the transaction at least partly in the form of a sale of the removed or damaged property would appear to exalt form over substance.

What makes a hard case even harder is the following: Two months after the decision here, Judge Raum of the Tax Court accorded capital gains treatment to a payment almost identical in nature. *Boston Fish Market Corp.*, 57 T.C. No. 92, at 884 (March 29, 1972). Sirbo immediately moved for reconsideration, but its motion was denied without a word of explanation. The government does not assert any pertinent distinction between the facts of the two cases; rather, it seeks to explain the disparate results on the ground that the taxpayer's contention in *Boston Fish Market* was that the lessee's payment was not income at all in light of the provision of I.R.C. § 109 excluding from gross income the value of a lessee's improvements to which the lessor falls heir on the termination of a lease and, once that point was decided against the taxpayer, the Commissioner abandoned his challenge to the propriety of capital gains treatment, see 57 T.C. at 887 n.2. The attempted explanation does not explain, for two reasons.

The first is that the Commissioner has a duty of consistency toward similarly situated taxpayers; he cannot properly concede capital gains treatment in one case and, without adequate explanation, dispute it in another having seemingly identical facts which is pending at the same

time. Compare *Moog Industries, Inc. v. FTC*, 355 U.S. 411, 414 (1958), with *FTC v. Universal-Rundle Corp.*, 387 U.S. 244, 250-52 (1967); K.C. Davis, *Discretionary Justice: A Preliminary Inquiry*, ch. VII (1969); L. Jaffe, *Judicial Control of Administrative Action* 700 (1965). That the Commissioner's seeming inconsistency may have arisen from the right hand's ignorance of the posture of the left is little solace to taxpayers who are entitled to a non-discriminatory administration of the tax laws by him, much less to a taxpayer like Sirbo who is disadvantaged by the discrimination in its case.⁷

The second reason is that Judge Raum did not rest on the Commissioner's concession. He said squarely that payments like that in *Boston Fish Market* and here "have generally been regarded as having been received in sale or exchange of the unrestored property," 57 T.C. at 889, citing several cases including the highly pertinent one of *Hamilton & Main, Inc.*, *supra*, 25 T.C. at 882, and Judge Murdock's concurring opinion in *Washington Fireproof Building Co.*, *supra*, 31 B.T.A. at 827-28.

[The Tax Court's failure to reconcile its decision here with that in *Boston Fish Market*, *cf.* IRC § 7460(b), may have rested, although this is only speculation, upon a belief that, under its ruling in *Jack E. Golsen*, 54 T.C. 742, 756-58 (1970), it was bound in this case by the dicta in *Billy Rose*, *supra*, 448 F.2d 549. We say dicta because, as indicated, the issue in that case was not whether the transaction came within I.R.C. § 1231 but whether a series of payments like the single payment here in question constituted income from "a sale or other disposition of real

⁷ This is not a situation where the Commissioner is obliged to take inconsistent positions in order to prevent the government from being whipsawed. See *United States Steel Corp. v. United States*, 445 F.2d 520, 525 n.7 (2 Cir. 1971), *cert. denied*, 405 U.S. 917 (1972).

property" or "a casual sale or other casual disposition of personal property" so as to qualify for treatment as an installment sale under I.R.C. § 453(b). In view of the background of the installment sale provisions, which are to be strictly construed, see 2 Mertens, *Law of Federal Income Taxation*, § 15.01 (1967); see, e.g., *Harry Leland Barnsley*, 31 T.C. 1260, 1263 (1959), one could conclude that the transaction in *Billy Rose* was not a "sale or other disposition of real property" for purposes of § 453(b) without deciding whether the income it generated should be treated as capital gains or ordinary income under § 1231—an issue which the taxpayer in that case did not raise. The case law offers examples of transactions allowed installment treatment under § 453(b)(1)(A) which were treated successively as capital gains and as ordinary income when the tax law changed before an installment obligation matured. See *Murray v. United States*, 426 F.2d 376, 381 (Ct. Cl. 1970) ("The function of section 453 is one of timing, not characterization. [U]se of the installment method defers the reporting of taxable gain, but in no way characterizes the nature of the gain.") See also *Snell v. C.I.R.*, 97 F.2d 891 (5 Cir. 1938); *Zola Klein*, 46 T.C. 1000 (1964); 2 Mertens, *supra*, § 15.11. Furthermore, the committee reports on § 212(d) of the Revenue Act of 1926, 44 Stat. 23, which purported to "define the situations and business to which such [installment] basis might be applied,"⁸ neither made explicit reference to characteriza-

8 Earlier Revenue Acts had provided for installment sales treatment only by implication. Regulations promulgated by the Commissioner, dating from 1919, providing for such treatment were ruled invalid or severely limited by earlier Board of Tax Appeals decisions. See *Manomet Cranberry Co.*, 1 B.T.A. 706, 708 (1925); *B.B. Todd, Inc.*, 1 B.T.A. 762, 767 (1925). The 1926 Act section was designed to "validate" these regulations. The 1926 provision has remained basically intact, undergoing only "the usual development in the case of new statutory provisions dealing with complicated problems." 2 Mertens, *supra*, § 15.02, at 7.

tion as capital gains nor referred solely to classes of transactions which today would demand capital gains treatment. H.R. Rep. No. 1, 69th Cong., 1st Sess. (1926), reprinted in Cum. Bull. 1939-1 part 2 at 346-47. In view of the different purposes of the two provisions, Congress might well be thought to have intended a more restrictive meaning for "sale or other disposition" in § 453(b) than for "sale or exchange" in § 1231(a). /

We freely concede that the *Billy Rose* court apparently considered the issues under §§ 453(b) and 1231 to be identical and that Judge Quealy cannot be faulted for believing that the *Billy Rose* panel would have rejected Sirbo's claim. But the Tax Court fulfills its duties under *Jack E. Golsen, supra*, if it respects *decisions* of a court of appeals to which appeals will be taken and should be free to voice its disagreement with statements not essential thereto; indeed, *Golsen* speaks of a duty to follow a "Court of Appeals decision which is squarely in point." 54 T.C. at 757. This is particularly true when, despite attempted distinction, *Billy Rose, supra*, 448 F.2d at 552 & n.1, the statements here relied upon by Judge Quealy are to some extent inconsistent with the main thrust of this court's earlier decision in *Ferrer*, which has been followed elsewhere. See, e.g., *United States v. Dresser Industries, Inc.*, 324 F.2d 56, 59 (5 Cir. 1963).

The basic inconsistency in approach between *Ferrer* and *Billy Rose* has already attracted comment, see 14 B.C. Ind. & Comm. L. Rev. 183 (1972). It may be that en banc proceedings will be needed to resolve this. However, even though the question is one of law, this court, before going down that path, should have the benefit of the considered views of the Tax Court, hopefully the full court, I.R.C.

§ 7460(b), on whether it would follow *Boston Fish Market*⁹ on the facts here if it deemed itself free to do so, as we think it is.¹⁰

The judgment of the Tax Court is vacated and the cause remanded for further proceedings consistent with this opinion. Costs shall abide the event.

9 We agree with the Commissioner that taxpayer's attempt to use its basis for the entire building to determine the amount of gain was unwarranted. But there would be no more difficulty in allocating taxpayer's basis in this case than in *Boston Fish Market*, see 57 T.C. at 889-90.

10 The Tax Court should require the Commissioner to explain and justify the different positions taken by him in this case and in *Boston Fish Market*.

UNITED STATES TAX COURT

SIRBO HOLDINGS, INC.,)

Petitioner,)

v.)

COMMISSIONER OF INTERNAL REVENUE,)

Respondent.)

Docket No. 515-69

STIPULATION

The parties hereby stipulate and agree that the attached certified copy of the Tax Court record in Boston Fish Market Corporation, Fulham and Maloney, Inc., Docket No. 6054-70 may be made a part of the record in this case. This record in Boston Fish Market is being made a part of the record in this case for the limited purpose of giving the respondent an opportunity to explain the apparent inconsistency in treatment between this case and Boston Fish Market as required by the United States Court of Appeals for the Second Circuit in its opinion at footnote 10. The opening briefs and reply briefs filed by both petitioner and respondent in Boston Fish Market

[- 2 -]

Corporation are included within the certified record and may be considered a part thereof.

The parties further stipulate and agree that the attached photostatic reproductions numbered Joint Exhibits 1-A through 15-D are copies of the original exhibits entered in the record in Tax Court Docket No. 6554-71. The exhibits, enumerated in the stipulation of facts, are as follows:

1-A - Consolidated United States corporate income tax returns filed on behalf of petitioners for taxable year 1965;

2-E - Consolidated United States corporate income tax returns filed on behalf of petitioners for taxable year 1966;

3-G - Consolidated United States corporate income tax returns filed on behalf of petitioners for taxable year 1967;

4-D - Consolidated United States corporate income tax returns filed on behalf of petitioners for taxable year 1968;

[3 -]

5-E - A lease dated September 25, 1947, between First National Stores, Inc. (lessee), and Boston Fish Market Corp.;

6-F - A sub-lease dated September 25, 1947;

7-G - A lease dated December 22, 1953, between First National Stores, Inc. (lessee) and Boston Fish Market Corp.;

8-H - A lease dated May 1, 1958 between First National Stores, Inc. (lessee) and Boston Fish Market Corp.;

9-I - A lease dated September 11, 1963 between First National Stores, Inc. (lessee) and Boston Fish Market Corp.;

10-J - A lease dated August 11, 1967, between First National Stores, Inc. (lessee) and Boston Fish Market Corp.;

11-K - A letter dated February 20, 1968, to Boston Fish Market Corp. from First National Stores, Inc.;

[- 4 -]

12-L - A letter dated March 5, 1968 to First National Stores, Inc. from Boston Fish Market Corp.;

13-M - A discharge from the lease of August 11, 1967 (Joint Exhibit 10-J) executed on March 28, 1968 by the Boston Fish Market Corp. in favor of First National Stores, Inc.;

14-N - A report prepared at the request of and for use by First National Stores, Inc. in negotiating the final settlement of its obligation to petitioner, Boston Fish Market Corp.;

15-O - A depreciation schedule of a portion of Boston Fish Market's depreciable assets.

/s/ Lester H. Salter

Lester H. Salter
Counsel for Petitioner

/s/ Lawrence B. Gibbs

LAWRENCE B. GIBBS
Acting Chief Counsel
Internal Revenue Service

UNITED STATES TAX COURT
WASHINGTON

~~SIRBO HOLDINGS, INC.~~ Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No.

515-69.

ORDER

By agreement of counsel for the parties, the Order of this Court entered July 31, 1973, scheduling this case for hearing on August 15, 1973, for such further proceedings as may be required pursuant to the Mandate of the United States Court of Appeals for the Second Circuit, is hereby amended, as follows:

ORDERED: That the case is stricken from the August 15, 1973 Motions Session.

IT IS FURTHER ORDERED: That within 30 days from the date hereof counsel for the respondent shall file for the record in this case, by stipulation or otherwise, the record and briefs in the case of Boston Fish Market Corp., 57 T.C. 884, decided March 29, 1972.

IT IS FURTHER ORDERED: That the respondent shall be allowed a period of 45 days from the date of such filing within which to submit a brief or memorandum setting forth the position of the respondent with respect to the matters set forth in the opinion of the United States Court of Appeals for the Second Circuit vacating the judgment of the Tax Court, and that counsel for the petitioner shall be allowed 30 days thereafter within which to submit any opposing briefs or memorandum.

(signed) William H. Quealy

William H. Quealy
Judge

Dated: Washington, D.C.
August 13, 1973

UNITED STATES TAX COURT

Sent to the Tax Court DEC 6 1971

BOSTON FISH MARKET CORPORATION,)
FULHAM AND MALONEY, INC.,)

Petitioners,)

v.)

COMMISSIONER OF INTERNAL REVENUE,)

Respondent.)

Docket No. 6054-70

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BRIEF FOR RESPONDENT

OFFICE OF REGIONAL COUNSEL
NORTH ATLANTIC REGION (BOS.)

K. MARTIN WORTHY
Chief Counsel
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OF COUNSEL:

MARVIN E. HAGEN
Regional Counsel
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Internal Revenue Code of 1954:

Section 61(a)(3)

Section 109

Section 1001

Section 1011

Section 1012

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Section 1231

UNITED STATES TAX COURT

BOSTON FISH MARKET CORPORATION,)
FULHAM AND MALONEY, INC.,)

Petitioners,)

v.)

COMMISSIONER OF INTERNAL REVENUE,)

Respondent.)

Docket No. 6054-70

BRIEF FOR RESPONDENT

PRELIMINARY STATEMENT

This is a case for the redetermination of deficiencies in income tax for the taxable years 1966 and 1968 in the following amounts:

<u>Year</u>	<u>Tax</u>
1966	\$ 6,750.59
1968	\$76,871.67

The trial was held before Judge Arnold Raum in Boston, Massachusetts on October 20, 1971. The evidence consists

of a stipulation of facts with exhibits attached. The Court requested the parties to file simultaneous main briefs on or before December 6, 1971 and simultaneous reply briefs on or before January 5, 1972.

A basis of settlement, involving concessions by petitioners and respondent, has been reached with regard to all issues except one. Consequently, a Rule 50 computation will be required regardless of how the Court decides the remaining issue.

QUESTION PRESENTED

1. Whether the sum of \$47,500.00, received by the petitioners in 1968 from a tenant in satisfaction of the tenant's obligation to restore the leased premises to their pre-lease condition, constituted long-term capital gain to the petitioners reportable in 1968.

RESPONDENT'S REQUEST FOR FINDINGS OF FACT

Respondent requests the Court to find the following facts:

1. Boston Fish Market Corporation and Fulham and Maloney, Inc., its wholly-owned subsidiary, the petitioners herein, are Massachusetts corporations, having their principal places of business at 253 Northern Avenue, Boston, Massachusetts 02210. (Stip., par. 1)
2. Petitioners filed Consolidated United States Corporation Income Tax Returns for the periods herein involved with the District Director of Internal Revenue, Boston, Massachusetts. (Stip., par. 2)
3. First National Stores, Inc., beginning on September 25, 1947, leased a certain portion of the leasehold improvements owned by Boston Fish Market Corporation on Boston Fish Pier. (Stip., par. 4)
4. Leases were executed or amended on September 12, 1947, December 22, 1963, May 1, 1958, September 11, 1963 and August 11, 1967. (Stip., par. 4)
5. The original lease covered stores 4, 6, 8 and 10 on the Fish Pier. The subsequent leases, beginning on

December 22, 1953, covered stores 4, 6, 8, 10, 12 and 14.

(Exhibits 5-E through 10-J) The store area occupied by lessee under the aforesaid leases did not exceed 10% of the total of petitioners' buildings on the Boston Fish Pier. (Stip., par. 9)

6. Each lease contained the following clause:

"if the Lessor so elects [the premises shall be] restored at Lessee's expense to their condition as _____ separate and individual stores. Such restoration shall follow in so far as possible the original plans of the stores in possession of the Lessor; so that each store so restored shall be separated from its adjoining store by a fireproof partition and shall contain a concrete front stairway to the second floor and concrete back stairways both to the second and to the third floors, three toilets, and separate electrical facilities and radiators, and an individual refrigerator chest or room as originally. Lessor shall notify Lessee in writing of its election to have the premises so restored, such election to be effective if such notice is received in the office of the Lessee on said premises on or before the _____ day before the termination of the lease or the date of the termination of any renewed term thereof, whichever is later." (Underlining added)

(Exhibits 5-E through 10-J)

7. The first blank in the above clause contained the number 4 in the 1947 lease document. In the subsequent lease documents, the first blank contained the

number 6. The second blank in the above clause contained varying numbers from tenth to forty-fifth. (Exhibits 5-E through 10-J)

8. In the early part of 1968, the lessee gave petitioners notice of its intention to terminate the lease and to vacate the premises. Petitioners notified the lessee of their election to have the premises restored to their original condition. Thereupon, the parties entered into negotiations for settlement of this issue. Settlement was arrived at by the payment made by the lessee to petitioners in the amount of \$47,500.00, in lieu of the lessee actually restoring the premises to their original condition. The money was paid to petitioners on or about March 28, 1968. (Stip., par. 5)

9. At the time of the execution of the final release between the lessee and petitioners and the payment of \$47,500.00, the lessee had no outstanding liability to petitioners under the terms of the lease for rent, since the rent had been paid in full through the period up to the termination date of the lease. (Stip., par. 6)

10. The aforesaid \$47,500.00 was not reported as taxable income of petitioners for 1968. Instead, the unrecovered basis of certain leasehold improvements, other than those described in the restoration clause of the leases, were reduced by book entries made as of January 1, 1968 in the total amount of \$47,500.00, as follows:

<u>Year</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Unrecovered Cost</u>
1957/62	\$ 66,377	\$49,617	\$16,760
1963	32,166	9,611	22,555
1964	12,940	4,755	8,185
Total	<u>\$111,483</u>	<u>\$63,983</u>	<u>\$47,500</u>

(Stip., par. 7)

11. The leasehold improvements which the tenant was obligated to restore consisted of (1) fireproof partitions; (2) concrete front stairways; (3) concrete back stairways; (4) toilets; (5) separate electrical facilities and radiators; and (6) individual refrigerator chests or rooms.

(Exhs. 5-E through 10-J and 14-N)

12. Petitioners did not maintain detailed asset ledgers. (Stip., par. 10)

13. According to the depreciation schedule attached to petitioners' 1967 corporate income tax return, petitioners' pier division had no remaining undepreciated basis

in any leasehold improvements acquired prior to 1957.

(Exh. 3-C) According to another of petitioners' depreciation schedules (pages 2 and 3 of Exh. 15-0), petitioners' pier division had no more than \$6,337.19 of undepreciated basis in leasehold improvements acquired prior to 1956.

14. The restoration clauses of the September 25, 1947 and the December 22, 1953 leases indicate that the respective fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators or individual refrigerator chests or rooms were in existence prior to the execution of the lease. (Exhs. 5-E through 10-J)

15. The restoration clauses of the September 25, 1947 and the December 22, 1953 leases along with the March 12, 1968 estimate of restoration cost (Exh. 14-N) indicate that the respective fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators and individual refrigerator chests or rooms had been removed prior to the termination of the leases.

ULTIMATE FACTS

Respondent requests the Court to find the following ultimate facts:

16. The fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators and individual refrigerator chests or rooms, described in the September 25, 1947 lease as part of stores 4, 6, 8 and 10, were necessarily constructed on or before September 25, 1947.

17. The fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators and individual refrigerator chests or rooms, described in the December 22, 1953 lease as part of stores 12 and 14, were necessarily constructed on or before December 22, 1953.

18. Petitioners' unrecovered basis in the fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators

and individual refrigerator chests or rooms, described in the September 25, 1947 and December 22, 1953 leases, which the lessee was obligated to restore and for which petitioners were paid \$47,500.00, could not have exceeded \$633.72 since the only basis which could be allocable to the leased property in question would be 10% of petitioners' alleged unrecovered basis of \$6,337.19 in pre-1953 leasehold improvements for the pier division and a great portion of such basis must necessarily be allocable to the buildings themselves and improvements not covered by the lease agreement. (Entire record)

19. Petitioners have failed to substantiate that they had any unrecovered basis in the assets which First National Stores was obligated to restore and for which petitioners were paid \$47,500.00. (Entire record)

POINTS RELIED UPON

When petitioners accepted the sum of \$47,500.00 from First National Stores in lieu of having certain fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators and individual refrigerator chests or rooms restored, petitioners, in effect, sold these assets.

Inasmuch as petitioners failed to establish any basis for the assets which were to have been restored, the entire \$47,500.00 is taxable as long-term capital gain.

Petitioners' reliance upon Section 109 of the Internal Revenue Code of 1954 is misplaced. That section excludes from gross income, income other than rent derived by a lessor or real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.

In the instant case, the tenant made no improvements which were left behind. What was left behind was the taxable sum of \$47,500.00 which, in effect, was left behind in payment for the assets removed for the tenant.

Petitioners' reliance on Hamilton & Main, Inc., 25 T.C. 878 (1956) is also misplaced. That case stands for the proposition that where an asset is purchased for a lump sum and is sold in pieces and the taxpayer shows that there is no way to apportion basis to each piece, the taxpayer may recover his entire lump sum basis before realizing any gain upon the sale of the pieces. In the instant case, in the nomenclature of the Hamilton & Main, Inc. case, assets were acquired in pieces, between 1913 and 1964, and not in a lump sum. Consequently, the case is inapplicable. In effect, what petitioners have done in the instant case is sell assets acquired on or before September 25, 1947 and on or before December 22, 1953. In an attempt to avoid taxation on the sales proceeds, petitioners reduced the basis of assets acquired after 1956. This is not permissible under the Hamilton & Main, Inc. case or any other authority.

ARGUMENT I

When petitioners accepted the sum of \$47,500.00 in lieu of having their premises restored to their pre-lease condition, petitioners, in effect, sold a portion of the premises, and the sales proceeds of \$47,500.00 are taxable as long-term capital gain in the year of receipt.

The instant case is not unlike the case of Washington Fireproof Building Co., 31 B.T.A. 824 (1934) wherein the taxpayer-landlord received a sum of money in lieu of having its premises restored to its original pre-lease condition as was required by the lease.

The majority opinion held the sum of money taxable on the grounds that the taxpayer had not met its burden of proof with regard to basis. Inasmuch as petitioners have failed to meet their burden of proof in the instant case with regard to the cost basis of the assets in issue, respondent should be sustained on the basis of the majority opinion in the Washington Fireproof Building Co. case.

However, the concurring opinion in the Washington Fireproof Building Co. case, while agreeing that the taxpayer failed to meet its burden of proof, suggests, and

we believe properly, that the money received in lieu of restoration would be reportable as income even if taxpayer had proved its basis in the assets to be restored.

At 31 B.T.A. 827, 828, the concurring opinion states:

"Money was paid to a lessor by a lessee in lieu of replacing substantial parts of a building which the lessee had removed and had agreed to replace. The question is, How much of the money settlement is income to the lessor? The answer to that question does not depend upon what the lessor did with the money nor upon how much money would have been necessary to restore the building. If all or some part of the money might be considered rent that would be all income. If all or any part of the money was not rent but a payment to the lessor for portions of his building, then to that extent the transaction was substantially similar to a sale and must be treated for income tax purposes as a 'sale or other disposition' of a portion of his building. Sec. 111. In such case he is entitled to have returned to him tax-free the original cost of the portion of the building removed but no more. If the amount of money paid for the portion of the building removed is in excess of the basis for gain or loss which the property removed had in the hands of the owner, adjusted for depreciation and obsolescence, gain is realized. If the amount received were less than the adjusted basis, loss would be sustained. If the lessee had completely removed the building and, rather than replace it, had settled in cash, clearly the excess of the cash over the basis of the building for gain or loss to the lessor would have been income to the lessor. The principle is the same

where only part of the building is removed and paid for in cash. Even if the difficulty of determining the portion of the basis against which to apply the cash were insurmountable, it would hardly change this fundamental method of determining income under the statute."

The principles enunciated by the concurring opinion in the Washington Fireproof Building Co. case were subsequently quoted and endorsed by this Court in Guy L. Waggoner, 15 T.C. 496 (1950) (Acq. C.B. 1951-1, 3).

It is respondent's position that petitioners, in effect, sold the assets which the tenant was obligated to restore and because petitioners cannot establish any unrecovered basis for the assets, the entire sales proceeds of \$47,500.00 are taxable in 1968, the year of receipt.

ARGUMENT II

Section 109 of the Internal Revenue Code of 1954 has no application in the instant case because the petitioners are not being taxed on the value of improvements made by the lessee on the leased premises and left behind by the lessee upon the termination of the lease.

It is respectfully suggested that petitioners' reliance upon Section 109 is totally and completely misplaced. Section 109, in its entirety, states:

"Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee."

In the instant case we are not concerned with the value of improvements left behind by a lessee upon the termination of a lease. We are concerned only with the proper tax treatment to be accorded the \$47,500.00 in cash paid to the lessor for certain assets which the lessee was obligated to restore.

ARGUMENT III

The case of Hamilton & Main, Inc., 25 T.C. 878 (1956),
relied upon by petitioners as authority for their having
reduced the basis of certain assets by \$47,500.00, in fact
supports the respondent's position that the entire \$47,500.00
in sales proceeds is taxable to the petitioners in 1968, the
year of receipt.

In the Hamilton & Main, Inc. case, the lessor's successor was paid the sum of \$10,000.00 by a lessee in lieu of having the premises restored to their pre-lease condition. Citing Guy L. Waggoner, supra and Washington Fireproof Building Co., supra, the Court, at 25 T.C. 882, described taxpayer's acceptance of the \$10,000.00 as the "sale or exchange of a capital asset".

After determining that the nature of the transaction was, in effect, the sale or exchange of a capital asset, the Court sought to determine the taxpayer's cost basis in the assets for which the \$10,000.00 was paid. In this regard, the Court stated at 25 T.C. 883:

"The established rule for determining profit where property is acquired for a lump sum and subsequently disposed of a portion at a time is that there must be an allocation of the cost or

other basis over the several units and gain or loss computed on the disposition of each part. If, however, apportionment is wholly impracticable or impossible no gain or loss is to be realized until the cost or other basis has been recovered."

Apparently, it is petitioners' position that it is impossible to determine the cost basis of the assets for which the \$47,500.00 was paid. However, the burden would be upon the petitioners to show that it is impossible to determine a basis for the assets involved. They have not met their burden, and for this reason alone, they would not come under the above-quoted portion of the Hamilton & Main, Inc. decision.

Even if petitioners could show that it is impossible to determine the exact basis for the assets involved, the Hamilton and Main Inc. decision would not require recovery of all of petitioners' basis in all of the assets, but of only the smallest ascertainable basis which completely includes the assets in question. In this case that would be no more than \$633.72.

Most of the stores in issue were first leased by First National Stores on September 25, 1947. All of the stores were leased by December 22, 1953. Petitioners' 1967 tax return showed no unrecovered basis, as of January 1, 1968, in assets acquired prior to 1947 or 1953. Petitioners' depreciation schedule shows only \$6,337.19 in undepreciated basis allocable to improvements made prior to the time that First National Stores

became a tenant. It has been stipulated that the leased stores did not exceed 10% of the total of petitioners' building on the Boston Fish Pier. Since a good portion of that would be allocable to the buildings themselves it follows that the unrecovered basis in the assets in issue amounted to only a small portion of the \$633.72, 10% of \$6,337.19.

This conclusion is corroborated in part by the partial description on the depreciation schedule (page 2 of Exhibit 15-0) of the post-1953 leasehold improvements, the basis of which was reduced by petitioners in the amount of \$47,500.00. The partial descriptions do not match the descriptions of the assets for which the \$47,500.00 was paid.

This conclusion is also corroborated in part by the fact that the assets, for which the \$47,500.00 was paid, were assets which appear by their nature to have been part of the original pre-1947 structure.

Finally, this conclusion is corroborated, beyond rebuttal, by the restoration clause contained in each lease document.

The restoration clause in the September 25, 1947 lease read as follows:

"if the Lessor so elects restored at Lessee's expense to their condition as four separate and individual stores. Such restoration shall follow in so far as possible the original plans of the stores in possession of the Lessor; so that each store so restored shall be separated from its adjoining store by a fireproof partition and shall contain a concrete front stairway to the second floor and concrete back stairways both to the second and to the third floors, three toilets, and separate electrical facilities and radiators, and an individual refrigerator chest or room as originally. Lessor shall notify Lessee in writing of its election to have the premises so restored, such election to be effective if such notice is received in the office of the Lessee on said premises on or before the forty-fifth day before the termination of the lease or the date of the termination of any renewed term thereof, whichever is later." (Underscoring added)

The assets which the tenant was obligated to restore consisted of (1) fireproof partitions; (2) concrete front stairways; (3) concrete back stairways; (4) toilets; (5) separate electrical facilities and radiators; and (6) individual refrigerator chests or rooms. The fact that these assets are described in detail in the restoration clause of the September 25, 1947 lease, with regard to stores 4, 6, 8 and 10, leads to the inescapable conclusion that the assets were in existence prior to the

execution of the lease. It follows, necessarily, that the described assets must have been constructed prior to September 25, 1947.

Utilizing the same reasoning, it follows that the portions of stores 12 and 14 that were to be restored under the December 22, 1953 lease must have been constructed prior to December 22, 1953.

The restoration clauses of the September 25, 1947 and the December 22, 1953 leases together with the March 12, 1968 estimate of restoration cost indicate that the partitions, stairways, toilets, electrical facilities and refrigerators were removed by or for the lessee prior to or during the term of the lease.

It follows that if the assets for which the \$47,500.00 was paid were constructed prior to September 25, 1947 and December 22, 1953, respectively, the 1957/62; the 1963 and the 1964 acquired assets, whose basis was reduced by \$47,500.00, were not the assets for which the \$47,500.00 was paid.

The assets for which the \$47,500.00 was paid were pre-1947/1953 assets, and as of January 1, 1968, petitioners'

only unrecovered pre-1947/1953 basis was not in excess of \$6337.19, only 10% of which (\$633.72) was applicable to the buildings involved herein.

The only proper place for the application of the Hamilton & Main, Inc. case, in the instant case, would be with regard to the \$633.72 unrecovered basis remaining in pre-1947/1953 assets. Only a portion of the \$633.72 basis is applicable to the assets removed for First National Stores. Had petitioners shown that it was impossible to determine what portion of the \$633.72 was applicable to the removed assets, petitioners would have been entitled to reduce the basis of the entire \$633.72. However, as pointed out by the Court, anything received in excess of the \$633.72 would still be fully taxable. "Capital recoveries in excess of cost do constitute taxable income." 25 T.C. 882.

In effect, what petitioners have done is reduce their basis in assets B, C and D to avoid taxation upon the sale of a part of asset A. This is not permitted under the Hamilton & Main, Inc. case or under any other authority.

CONCLUSION

It follows that the determination of the Commissioner of Internal Revenue, with regard to the only issue remaining in the case, should be sustained.

K. Martin Worthy
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Brief Initialed Page

In re: Boston Fish Market Corp.
Docket No. 6054-70

Name	Date
William J. Hayes	11/16/71
James E. Markham, Jr.	11/18/71
Charles Brown	12/3/71
J. H. Kelly	12/4/71

Please note —
Original Brief Initialed
Page was misplaced &
this substitute was prepared
J. H. Kelly

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UNITED STATES TAX COURT

BOSTON FISH MARKET CORPORATION,
FULHAM AND MALONEY, INC.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 6054-70

REPLY BRIEF FOR RESPONDENT

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UNITED STATES TAX COURT

BOSTON FISH MARKET CORPORATION,
FULHAM AND MALONEY, INC.,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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) Docket No. 6054-70
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REPLY BRIEF FOR RESPONDENT

PRELIMINARY STATEMENT

The trial was held before Judge Arnold Raum in Boston, Massachusetts on October 20, 1971. Simultaneous main briefs were filed on or before December 6, 1971. Simultaneous reply briefs are due on or before January 5, 1972.

RESPONDENT'S OBJECTIONS TO PETITIONER'S
REQUESTED FINDINGS OF FACT

Respondent respectfully agrees with, objects to, and offers substitutions for petitioner's Requested Findings of Fact as follows (the paragraphs being numbered to correspond with the paragraphs as designated by petitioner):

1. through 4. No objection.

5. Respondent objects to petitioner's proposed finding No. 5 on the grounds that it is incomplete and therefore misleading. In lieu thereof respondent would substitute respondent's original requested findings No. 3, 4, and 5 as more complete.

6. Respondent agrees with petitioner's proposed finding No. 6 but would substitute therefore respondent's original requested findings No. 6 and 7 as more complete.

7. through 10. No objection.

11. Respondent agrees with petitioner's proposed finding No. 11 but would substitute therefore respondent's original requested finding No. 10 as more complete.

12. Respondent objects to petitioner's proposed finding No. 12 on the grounds that it is incomplete and therefore misleading. In lieu thereof respondent would substitute respondent's original requested findings No. 11, 12, 13, 14 and 15 as more complete.

ARGUMENT I

Petitioners' primary position, as set forth in their main brief, is that Section 109 of the Internal Revenue Code of 1954* excludes from gross income the sum of \$47,500.00, which petitioners received from a tenant upon termination of a lease in lieu of having the tenant meet its lease obligation of restoring the leased premises to its original pre-lease condition. Section 109, in its entirety, states:

"Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee." (Underscoring added)

Petitioners' reliance upon this section is misplaced for at least two very important reasons. First, the language, the legislative history and the cases decided under this section clearly indicate that Section 109 was never

*Hereinafter, all section references will be to the 1954 Code unless otherwise noted.

intended to exclude cash receipts from income. Its sole intention was to exclude from income, in some cases, the "value of property" received upon the termination of a lease. Hearings before the Senate Finance Committee on H.R. 7378, 77th Cong., 45 (July 23, 1942).

Second, the "value of property" to be excluded from income under Section 109 must be attributable to "buildings erected or other improvements made by the lessee". In the instant case, no buildings were erected and no improvements were made by the lessee.

Petitioners imply that the removing of (1) the fire-proof partitions; (2) the concrete front stairways; (3) the concrete back stairways; (4) the toilets; (5) the separate electrical facilities and radiators; and (6) the individual refrigerator chests or rooms improved the leased premises. However, there is absolutely no proof that the removals "improved" the property or, if they did improve the property, that the removals were carried out by the lessee, rather than the petitioners. But this is of no consequence, as petitioners are not being taxed on any unestablished increase in value allegedly attributable to the claimed "improvements".

The Tax Court has consistently held in similar factual situations that there was a sale or exchange of capital assets. It follows a fortiori that Section 109 cannot be applicable. Hamilton & Main, Inc., 25 T.C. 878 (1956); Guy L. Waggoner, 15 T.C. 496 (1950) (Acq. C.B. 1951-1, 3); Washington Fireproof Building Co., 31 B.T.A. 824 (1934).

The asserted deficiency in this case results from the receipt of cash, not from the receipt of value in the form of buildings or other improvements erected or made by the lessee. Consequently, Section 109 is completely inapplicable.

ARGUMENT II

In their first alternative argument, on page 19 of their main brief, petitioners acknowledge that they sold the fireproof partitions, concrete front stairways, concrete back stairways, toilets, separate electrical facilities and radiators, and individual refrigerator chests or rooms.

This, of course, is respondent's only position, and it is adequately supported by the case law. Hamilton & Main, Inc., 25 T.C. 878 (1956); Guy L. Waggoner, 15 T.C. 496 (1950) (Acq. C.B. 1951-1, 3); Washington Fireproof Building Co., 31 B.T.A. 824 (1934).

However, in an attempt to avoid the taxable consequence of calling the transaction a sale or exchange, petitioners have claimed that they are entitled to a basis recovery equal to the \$47,500.00 sales proceeds. In support of this position, they quote the following passage from Hamilton & Main, Inc., supra, at 25 T.C. 883.

"The established rule for determining profit where property is acquired for a lump sum and subsequently disposed of a portion at a time is that there must be an allocation of the cost or other basis over the several units and gain or loss computed on the disposition of each part. If, however, apportionment is wholly

impracticable or impossible no gain or loss is to be realized until the cost or other basis has been recovered. * * *."

As was pointed out in respondent's main brief at page 18, this passage supports the respondent's position, rather than petitioners'. First, petitioners have failed to meet their burden of proof by failing to show that the basis for the assets involved could not be ascertained.

Second, respondent has shown in his main brief that the basis of the assets in issue could not exceed a very small portion of \$633.72. It follows that even if the Hamilton & Main, Inc. case were applicable, it would only permit the recovery of \$633.72 in basis. Everything in excess of \$633.72 would be taxable.

"It is not to be overlooked, however, that capital recoveries in excess of cost do constitute taxable income."

Hamilton & Main, Inc., supra, at 25 T.C. 882.

ARGUMENT III

Petitioners' second alternative argument is not unlike their first alternative argument. It also acknowledges that there has been a sale or exchange but seeks an unsubstantiated basis.

Petitioners contend, without proving, that they cannot identify the cost basis of the assets involved. They note that since their depreciation schedule for all of their assets as of December 31, 1967 shows an undepreciated basis of at least 50% of original cost, it is not unreasonable to assume that the instant assets had an undepreciated basis of at least 50% of the amount received.

The answer to this argument is, of course, that it is patently unreasonable to assume that the basis of the assets involved had an undepreciated basis of at least 50% of \$47,500.00. The stipulated facts show that the basis of the assets involved could not have exceeded a small portion of \$633.72. See respondent's main brief, pages 18 through 22.

CONCLUSION

It follows that the determination of the Commissioner of Internal Revenue, with regard to the only issue remaining in the case, should be sustained.

(Signed) K. Martin Worthy
GHJ

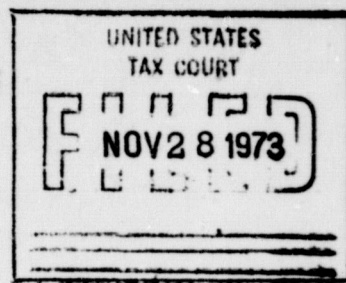
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Chief Counsel
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OF COUNSEL:

MARVIN E. HAGEN
Regional Counsel
WILLIAM T. HAYES
Attorney
Internal Revenue Service

UNITED STATES TAX COURT

Copy



SIRBO HOLDINGS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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) Docket No. 515-69
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BRIEF FOR RESPONDENT ON REMAND

MEADE WHITAKER
Chief Counsel
Internal Revenue Service

OF COUNSEL:

ROBERT A. BRIDGES, Director
Tax Court Litigation Division
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Internal Revenue Service

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A. The principle of equality of treatment of all taxpayers does not require that erroneous treatment granted to one taxpayer be extended to all similarly situated taxpayers. Page 17

B. After reconsideration, the Commissioner has concluded that the concession in Boston Fish Market was erroneous, however, this concession was not unreasonable in view of certain factors present in that case. Page 21

II. THIS COURT'S DECISION HEREIN WAS CORRECT AND SHOULD BE RE-AFFIRMED.

A. The \$125,000 payment by CBS was not received by petitioner as the proceeds from a "sale or exchange" of a "capital asset" under sections 1221 and 1222. Page 24

B. The \$125,000 payment received by petitioner was paid by CBS in liquidation of its contractual obligation to restore petitioner's property and not as payment for damages done to petitioner's property. Page 38

- C. There is no basis for the Second Circuit's suggestion that the term "sale" as used in section 453 was intended to have a more restrictive meaning than the term "sale" as used in section 1231.

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- D. The capital gain versus ordinary income issue in Boston Fish Market was conceded by the Commissioner and not decided by Judge Raum. Thus, there was no inconsistency between that decision and the decision herein which would require that Sirbo's petition for rehearing be granted.

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STATUTES INVOLVED

Internal Revenue Code of 1954:

Sec. 1221. Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include--

* * * *

Sec. 1222. Other terms relating to capital gains and losses.

For purposes of this subtitle--

(3) Long-Term capital gain. The term "long-term capital gain" means the gain from the sale or exchange of a capital asset held for more than 6 months, if, and to the extent, such gain is taken into account in computing gross income.

Sec. 1231. Property used in the trade or business and involuntary conversions.

(a) General rule.

If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.

* * * *

(b) Definition of property used in the trade or business.

For purposes of this section--

(1) General rule. The term "property used in the trade or business" means property used in

the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not--

* * * *

Sec. 453. Installment method.

(a) Dealers in personal property.

(1) In general. Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

* * * *

(b) Sales of realty and casual sales of personalty.

(1) General rule. Income from--

* * * *

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding \$1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

* * * *

Sec. 109. Improvements by lessee on lessor's property.

Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.

UNITED STATES TAX COURT

SIRBO HOLDINGS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

)
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) Docket No. 515-69
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BRIEF FOR RESPONDENT ON REMAND

Preliminary Statement

This case is before the Tax Court on remand from the United States Court of Appeals for the Second Circuit. The remand was ordered (1) for purposes of having the Commissioner explain the apparently different positions taken by him in this case and Boston Fish Market Corp., 57 T.C. 884 (1972), and (2) to allow this Court to consider whether it would have decided this case differently had it not believed Billy Rose's Diamond Horseshoe, Inc. v. United States, 448 F.2d 549 (1971), to be a controlling precedent under the rule in Jack E. Golsen, 54 T.C. 742, (1970).

Pursuant to the agreement of the parties, further hearing was deemed unnecessary. By stipulation filed September 12, 1973, the record and briefs in Boston Fish Market, supra, were filed for the record herein. By order dated August 13, 1973, the Court ordered seriatim briefs. Pursuant to an extension granted by the Court on October 25, 1973, the Commissioner's brief is due on November 28, 1973 and the petitioner's brief is due 30 days thereafter on December 28, 1973.

Questions Presented

I. Whether the Commissioner breached his duty of consistency by conceding that Boston Fish Market realized capital gains from the receipt of cash in satisfaction of its tenant's obligation to restore the leased premises, while contending herein that a similar payment constituted ordinary income to petitioner.

II. Whether the amount received by petitioner in satisfaction of its tenant's obligation to restore the leased premises constituted gain from the "sale or exchange" of a "capital asset" to the extent that it exceeded petitioner's basis in the property damaged, destroyed, or removed.

STATEMENT OF FACTS

The facts herein and in Boston Fish Market, supra, are set forth in the opinions of this Court and the Court of Appeals for the Second Circuit. Sirbo Holdings, Inc., 57 T.C. 530 (Quealy, J.); vac'd and rem'd 476 F.2d 981 (2nd Cir. 1973); Boston Fish Market Corp., 57 T.C. 884 (Raum, J.). The Commissioner is not requesting any further findings of fact with respect to either case; however, he would point out the following two findings in Boston Fish Market which are relevant to the Commissioner's explanation of the positions taken in these two cases.

(A) The required restorations consisted of (1) the construction of walls to divide the various stores from one another, (2) the installation of specified concrete stairways, (3) the installation of a certain number of toilets and sinks, (4) certain electrical work, and (5) the reconnection of existing radiators. Such repairs or restorations were required as a result of First National's removal, disconnection, or destruction, during the terms of the various leases or at the commencement of the initial leases, of the designated walls, stairways, plumbing fixtures, electrical wiring and heating apparatus.

(B) At the time of the execution of the final release by petitioner and the payment of the \$47,500, First National, as lessee, had no outstanding liability for rent under the terms of the lease inasmuch as the rent had been paid in full for the period of time up to the termination date of the lease.

INTRODUCTION

Petitioner's principal argument throughout the trial and appeal of this case has been that the payment received from CBS represented proceeds from an "involuntary conversion" of property used in petitioner's trade or business which had been held for a period in excess of six months and that the gain on such "involuntary conversion" is taxable as capital gain under the provisions of section 1231, I.R.C. of 1954. Alternatively, petitioner made an argument that the payment from CBS represented damages for injury to petitioner's capital which would be taxable as capital gain. Although petitioner made no claim that the damage to its capital was essentially equivalent to a "sale or exchange" of the business property so damaged, this Court and the Second Circuit so interpreted the argument.

Both Courts had no difficulty in finding that the conversion of petitioner's property was contemplated

and permitted by the various leases and that Sirbo freely agreed to the \$125,000 payment in lieu of restoration. Consequently, the conversion of petitioner's business property was not "involuntary" within the meaning of section 1231. This argument is thus not in issue on remand.

With regard to the "sale or exchange" issue, this Court relied on the Second Circuit case of Billy Rose's Diamond Horseshoe, supra, in finding that no "sale or exchange" occurred because no property passed to CBS. Rather, the payment by CBS and the release by Sirbo resulted in "extinguishment" of the contractual rights possessed by Sirbo.

In vacating and remanding with regard to the "sale or exchange" issue, the Second Circuit made several observations which may be summarized as follows:

(1) The payment to Sirbo was not based entirely upon the relinquishment of the right to have restoration. At least in part, the payment was for the destruction or damage of Sirbo's business property. The result herein appears to exalt form over substance since capital gain treatment would

have been available had the lease obligated CBS to pay for the damage or destruction to the property rather than casting the transaction in the form of a right to restoration.

(2) Despite the attempted distinction by the panel in Billy Rose, supra, 448 F.2d at 552 & n.1, the statements relied on by Judge Quealy are to some extent inconsistent with the main thrust of the Second Circuit's earlier decision in Commissioner v. Ferrer, 304 F.2d 125, (2nd Cir. 1962).

(3) In Billy Rose, supra, the issue was whether a landlord receiving a series of notes in satisfaction of an obligation to restore was entitled to the benefits of the installment sales provisions of section 453, I.R.C. of 1954. Section 453 is a relief provision and is to be construed narrowly. The function of this section is timing of income and not characterization of income as capital or ordinary. Consequently, it is possible to determine that a transaction is not a "sale or other disposition" for purposes of section 453 without determining whether the transaction constituted a "sale or exchange" under section 1231.

(4) The facts in Boston Fish Market, supra, are essentially identical to the facts herein, yet the Commissioner conceded the capital gains issue in that case. The Commissioner cannot, without explanation, properly concede capital gain treatment in one case while contesting the issue in a case with seemingly identical facts. The Commissioner should justify this seeming inconsistency on remand. The

Tax Court itself did not rely solely on the Commissioner's concession of this issue in Boston Fish Market, supra, as Judge Raum specifically found that "similar 'cash' payments have generally been regarded as having been received in sale or exchange of the unrestored property." 57 T.C. at 889. The Tax Court's failure to grant Sirbo's petition for rehearing in light of the Boston Fish Market opinion may have resulted from the Court's view that the result herein was dictated by Billy Rose. On remand the Tax Court should consider whether a result consistent with Boston Fish Market would be reached herein if the Court felt itself free to do so.

The Respondent's view is that the Second Circuit's opinion did not foreclose consideration of any of the foregoing points. Rather, the Court intended that this Court consider and decide these questions on remand.

ARGUMENT

I

THE COMMISSIONER BREACHED NO DUTY OF
CONSISTENCY TO PETITIONER BY VIRTUE OF
HIS CONCESSION IN BOSTON FISH MARKET.

- A. The principle of equality of treatment of all taxpayers does not require that erroneous treatment granted to one taxpayer be extended to all similarly situated taxpayers.

The United States taxes its citizens through what is essentially a voluntary, self-assessing system. Relative to the total taxes collected, the Commissioner's enforcement capabilities are extremely limited, and they must serve the dual purpose of resolving legitimate controversies as to taxability and acting as a deterrent to those who would intentionally avoid their responsibilities as citizens. Given the foregoing tax system, it is obvious that there will always be those who will escape their lawful share of the tax burden through willfulness, ignorance or the Commissioner's

inability to enforce 100% compliance. Clearly, a taxpayer cannot be allowed to escape the taxes he lawfully owes simply because his neighbor escapes taxation. See, Robert F. Wagner, Jr. v. United States, 387 F.2d 966 (Ct. Cls. 1967).

Every year, the Commissioner audits several million tax returns involving untold numbers of issues. Many thousands of these audits produce cases which are unagreed initially. A substantial number of the unagreed cases are settled and those that are not settled must then be resolved in the courts. Since all the decisions necessary with regard to these cases cannot be made by one person or a small group of persons, there will inevitably be differences of treatment both at the administrative and judicial levels.

Uniformity of treatment on a nationwide basis is obviously desirable and it is a goal upon which the Commissioner places the highest priority. Yet, when inconsistencies occur, as they must, no legal principle requires that the Commissioner compound the error by extending such erroneous treatment to

other taxpayers. Petitioner can hardly claim to have been prejudiced or disadvantaged by the Commissioner's treatment of Boston Fish Market since it in no way relied on such treatment, and in fact, it was not aware of such treatment until after its own tax liability had been determined by this Court.

Apart from the obvious danger of perpetuating errors, interpretation of the principle of equality of treatment as creating a "duty of consistency" on the part of the Commissioner would present a potentially enormous administrative problem for both the Commissioner and the courts. As noted previously, the majority of unagreed cases are ultimately settled. Any number of valid reasons may exist for settlement or concession of an issue which is apparently the same as an issue in litigation, i.e., the issue may in fact not be the same due to the presence or absence of a particular factor, the issue may be conceded due to the lack of evidence or the issue may be identical and have been settled as a "trade-off" for a more important issue.

A "duty of consistency" on the part of the Commissioner which could be invoked by a taxpayer in litigation would force the Commissioner to explain in every case his handling of similar issues on an administrative level. While the treatment accorded in the vast majority of settled cases could be readily explained and justified, the necessity for such explanations would unduly complicate tax litigation and interfere with the orderly functioning of the courts.

- B. Upon reconsideration, the Commissioner has concluded that the concession in Boston Fish Market was erroneous. However, this concession was not unreasonable in view of certain factors present in that case.

The primary issue in Boston Fish Market was whether a cash payment, received by a lessor in satisfaction of a tenant's obligation to restore the premises, is excludable under section 109, I.R.C. of 1954, which provides for exclusion of income attributable to improvements to the leasehold by the lessee which inure to the lessor upon the termination of the lease. Assuming that the taxpayer did not prevail on the primary issue, the question then arose as to whether the gain was capital or ordinary.

In concluding that the Service should concede that the gain was capital in nature, the Commissioner's counsel and the Appellate conferee relied on the following two factors which are not present in this case:

(1) Restoration of the property would have involved only the replacement or repair of items which had been removed or rendered inoperable. This is contrasted to the instant case where a large portion of the cost of restoration would be attributable to the removal of the elaborate improvements placed on the property by CBS.

(2) The lease had been terminated and no further payments were due with respect to the lease. Herein, there was merely an up-dating of the restoration agreement and occupancy continued under a new lease.

Upon reconsideration in connection with the instant case, it has been determined that the foregoing factors do not provide a sufficient distinction between these two cases. Had Boston Fish Market cast its transaction in the form of a sale of the removed or damaged property, it would possibly be entitled to capital gains. However, it did not so cast its transaction nor did the parties intend that a sale or payment for damages take place.

Superficially, the timing of the payment for release of the restoration obligation in Boston Fish Market makes it less obvious that the payment was simply an additional amount paid for use of the premises. When considered in depth, however, it is clear that in both cases the rent paid for the use of the premises consisted of two elements: (1) A fixed amount for use of the existing structure, and, (2) An indeterminate amount measured by the cost of restoration in exchange for the privilege of adapting the premises to the lessee's needs. In essence, the only thing acquired by the lessee in exchange for the restoration payment was a freer use of the property.

Although the respondent has concluded that the distinguishing factors in Boston Fish Market are not sufficient to dictate a different result, it should be recognized that the decision of the respondent's representatives to concede the capital gains issue in that case was not unreasonable inasmuch as they were dealing with a case in which the facts, as indicated, are less favorable to the Commissioner than in the instant case.

E 24 -7

THIS COURT'S DECISION HEREIN WAS CORRECT
AND SHOULD BE RE-AFFIRMED

- A. The \$125,000 payment by CBS was not received by petitioner as the proceeds from a "sale or exchange" of a "capital asset" under sections 1221 and 1222.

Having failed to prove an involuntary conversion under section 1231, petitioner can still qualify for capital gain treatment only if its transaction constitutes a "sale or exchange" of either a "capital asset" as defined by section 1221 or "property used in the trade or business" as defined by section 1231(b).

A sale in the context of the capital gains provisions has been defined as follows (Brown v. Commissioner, 380 U.S. 563 (1965), at 571):

"A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent," Iowa v. McFarland, 110 U.S. 471, 478; it is a contract "to pass rights of property for money, --which the buyer pays or promises to pay to the seller . . .," Williamson v. Berry, 8 How. 495, 544." [Emphasis added.]

The Commissioner submits that no "sale or exchange" took place herein inasmuch as no property passed to CBS by virtue of its payment to petitioner.

E 25 -7

At the time of the transaction, petitioner possessed the bare contractual right to have CBS restore its property.¹ When petitioner received payment from CBS, that right was liquidated or extinguished.

Nothing passed to CBS. Billy Rose, supra; Commissioner v. Pittson Co., 252 F.2d 344, (2nd Cir. 1958); Commissioner v. Starr Bros., Inc., 204 F.2d 673, (2nd Cir. 1953).

As the Second Circuit noted, Billy Rose, Pittson and Starr Bros. are to some extent inconsistent with that Court's decision in Ferrer, supra, and thus a hearing en banc may be necessitated if this case again reaches that Court. Ferrer involved an agreement by the actor Jose Ferrer to produce a play entitled "Monsieur Toulouse" based on the book "Moulin Rouge," which was the life story of Toulouse-Lautrec. In exchange for his agreement to produce the stage play

1. This argument presumes that the payment was based on the contractual obligation to restore and not upon any obligation to pay for damages to Sirbo's property as suggested by the Second Circuit. Since the right to restoration is not real property and is not subject to the allowance for depreciation, it can only qualify for capital gains as a sale of a capital asset under section 1222. The Second Circuit's suggestion that the payment was, in part, for damage to Sirbo's property will be dealt with in a subsequent section of this brief.

and certain advance royalties, Ferrer received three distinct rights from the author, Pierre LaMure: (1) a lease of the exclusive right to produce the play on the speaking stage in the United States and Canada, (2) incident to the lease, the right to prevent the disposition of the motion picture rights for a certain period and the right to prevent the disposition of the radio and television rights for a further period, and (3) the right to share in the proceeds of any motion picture to the extent of 40% for the first ten years and a diminishing percentage thereafter.

Prior to the production of the play, Ferrer and LaMure agreed with one John Huston that the story should be made into a movie, in which Ferrer would star, without having first been produced as a play. Huston insisted on the annulment or conveyance of Ferrer's agreement with LaMure. Ultimately, a contract was entered into by LaMure and Huston's company (Moulin) whereby LaMure conveyed all motion picture rights. The contract was predicated on the

conveyance of Ferrer's rights also and further indicated that Ferrer would receive certain fixed amounts as salary plus certain percentages of the eastern and western hemisphere profits from the movie. The percentages of profit were intended to compensate Ferrer for his contractual rights to the production of the play. The Commissioner contended that the amounts received pursuant to the percentage provisions were ordinary income to Ferrer.

In an opinion by Judge Friendly, the Second Circuit made the following statement which the Commissioner believes is the key to interpreting that decision:

In the instant case, we can see no sensible business basis for drawing a line between a release of Ferrer's rights to LaMure for a consideration paid by Moulin, and a sale of them, with LaMure's consent, to Moulin or to a stranger who would then release them . . . Tax law is concerned with the substance, here the voluntary passing of "property" rights allegedly constituting "capital assets," not with whether they are passed to a stranger or to a person already having a larger "estate."

Apparently, the Second Circuit was construing the "extinguishment doctrine" as preventing capital gains treatment on the sale of contractual rights by the obligee to the obligor (or the obligor's assignee) merely because of the relationship of the parties. In fact, the "extinguishment doctrine" does come into play only when an obligor seeks to be released from his contractual obligation through payment to the obligee. However, the first question is whether any property was transferred so as to constitute a "sale."

In providing for capital gains treatment in section 1222, Congress limited such treatment to the gain realized upon the "sale or exchange" of "capital assets." There are thus two requirements to be satisfied in every capital gain transaction under this section. These requirements must be met regardless of whether the property involved is real property, tangible personal property or intangible personal property such as was involved herein.

The "sale" requirement tends to be overlooked in the vast majority of cases simply because the transaction is obviously a "sale" and no question is ever raised. Consequently, most cases concentrate on whether the property involved was a "capital asset." Yet, inherent in all capital gain v. ordinary income cases is a tacit determination that the transaction was a sale rather than a gift, contribution, abandonment, release or other non-sale transaction.

The "extinguishment doctrine" is one of the tests used for determining whether a "sale" has taken place. Its application is quite limited, applying only to release of contractual rights to the party who owes the duty corresponding to the right. If only a bare contractual right representing nothing more than the obligor's promise to undertake a certain duty is involved, no property rights can be transferred to the obligor because one cannot

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owe oneself a legal duty. The "extinguishment doctrine" then holds that there has been no "sale" because nothing has been transferred to the ostensible purchaser. Inasmuch as there has been no "sale," it then becomes unnecessary to look further to determine whether or not the property involved was a "capital asset."

The extinguishment doctrine asks whether a contract right is sufficiently a substantial property right to survive the transaction, so that it continues to exist in the hands of the transferee. Commissioner v. Pittston Co., supra. In determining whether a contract right is sufficiently substantial, the doctrine looks to what the right represents in the hands of the transferee as well as the transferor. If in the hands of the transferee, it represents nothing more than a theoretical right to compel the transferee to perform some duty to itself and thus cannot be sold to a third party, nothing of substance has passed to the transferee. In such event no sale has occurred under the extinguishment doctrine because a sale is ". . . a transfer of property for a fixed price in money. . . ." Commissioner v. Brown, 380 U.S. 563, 571 (1965).

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Applying the extinguishment doctrine to the present case reveals that there was no sale or exchange. Before the transaction, petitioner owned the legal right to compel CBS to restore the premises to their 1947 condition. Upon the payment of \$125,000, that right was completely extinguished, and nothing passed to CBS. Because a "sale" requires a transfer of property for a fixed price in money or its equivalent and because no property passed to CBS in return for its \$125,000 payment, no sale occurred.

On the other hand, an entirely different situation is presented if the contractual agreement creates an interest in property which is more substantial than a mere contract right and which does not lose its existence upon transfer. The transfer of such property right to the obligor or "creator" of such property right will constitute a "sale" for purposes of section 1222. See, Commissioner v. Golonsky, 200 F.2d 72, (2nd Cir. 1952), cert. den., 345 U.S. 939, (1953); Commissioner v. McCue Bros. & Drummond Inc., 210 F.2d 752, (2nd Cir. 1954), cert. den. 348 U.S. 829, (1954); Commissioner v. Ray, 210 F.2d 390, (5th Cir. 1954), cert. den. 348 U.S. 829, (1954); and Rev. Rul. 56-531, C.B. 1956-2, 983.

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The "extinguishment doctrine" is thus operative only in instances where no property passes to the ostensible purchaser. It does not hold that there is no "sale" of a property right created by contract merely because the property right is being transferred to the obligor or "creator" of the right. Evidently, the Ferrer panel mistakenly believed that the "extinguishment doctrine" would find that there was no "sale" regardless of the nature of Ferrer's rights and whether they were capable of surviving in the hands of LaMure or his assignee. On this basis, the Ferrer panel refused to apply the "extinguishment doctrine," holding instead that the question for resolution was whether Ferrer's rights were "capital assets."

Thus, the Ferrer panel omitted the "sale" test and proceeded directly to the "capital asset" test. Under the Ferrer rationale, a court would find a sale or exchange when the transferor transfers a contract right by cancellation, release, or otherwise without regard to whether that right actually passes

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(survives) into the hands of the transferee. See Ferrer v. Commissioner, supra, at 130-131. In effect, the Ferrer case interprets the word "transfer" to include a mere giving up of contract rights, whereas respondent, under the extinguishment doctrine, interprets "transfer" as requiring not only the giving up of a contract right, but also, the actual passage of that right to the transferee. In analyzing Ferrer's rights, the Second Circuit found that the lease of the right to produce the stage play and the right to prevent the disposition of the movie, radio and TV rights, for a certain period, gave Ferrer an "equitable interest" in these portions of the copyright because he would be entitled to injunctive relief to prevent interference with these rights. The right to share in the proceeds from the motion picture rights did not have the same status. La Mure reserved all title interest in this portion of the copyright. Ferrer had no say in whether, if or for

what price the motion picture rights would be disposed of. Ferrer's only right was to share in the proceeds when and if the motion picture rights were sold.

Assuming that Second Circuit correctly interpreted Ferrer's rights on the facts, the result reached was the same as would have been reached had the Court properly considered the "sale" requirement first. The lease of the stage play rights and the right to prevent disposition of the motion picture, radio and TV rights for a certain period of time effectively "carved out" these rights from the copyright. When transferred to LaMure or his assignee, these rights again merged with the larger estate, i.e., the copyright. While not retaining their separate identities, these rights did not vanish inasmuch as the larger estate was greater than it had been prior to the transfer. Thus, these rights were not "extinguished" and it then became necessary to consider whether these rights were "capital assets" in Ferrer's hands.

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The right to share in the proceeds from the motion picture rights created no such property right. Upon the attempted transfer to LaMure or his assignee, this right vanished since one cannot owe himself a duty to pay over a portion of the earnings from certain property.

For our purposes, it is not necessary to determine whether the Second Circuit correctly concluded that the lease of the play and the right to prevent disposition of the motion picture, radio and TV rights for a certain period were "capital assets." The point is that this determination would still have been necessary if the Court had properly considered the "sale" question first and concluded that the transaction was a sale or exchange. With respect to the right to share in the proceeds from the motion picture rights, the Court properly concluded that it was only a right to receive future income and therefore not a "capital asset." However, under respondent's view, it was not necessary to reach this question because this right was not susceptible of being "sold" to the party owing the corresponding duty.

The conceptual difficulty the courts have experienced in applying the "sale" and "capital asset" tests in situations involving contract rights arises from their similarity. Ordinarily, a right to receive future income, which is not a "capital asset," cannot survive transfer to the party owing the duty to pay over the income while a "capital asset" will be of sufficient substance to survive transfer to the obligor or "creator" of such property right. Because it is impossible to consider every conceivable factual circumstance, the Commissioner takes no position as to whether the two tests should always reach the same result in the context of contractual rights.

Regardless of the objective of maintaining consistency in the consideration of transfers of real property, tangible personal property and contractual rights (intangible personalty), a very valid reason exists for retention of the two separate tests in considering transfers of contract

rights. In order to determine whether property constitutes a "capital asset," it is necessary to examine all the facts to determine what the particular property represents in the hands of the holder. To say that reasonable men can differ on such an analysis is to vastly understate the case. The situation at hand is an excellent case in point. The Commissioner considers the payment from CBS to Sirbo to represent an additional payment for the use of property, specifically, for the right to use the property in any manner it saw fit. At a minimum, determination of what the right constituted in Sirbo's hands presents difficulties that are not present in determining whether the ostensible transfer of the right to CBS constituted a "sale." Whatever the right constituted in Sirbo's hands,

it is obvious that CBS received nothing for its payment other than the right to use the property, and therefore, there was no "sale" within the meaning of section 1222.

Faced with a situation involving only a bare contractual right which could not survive transfer to the party owing the corresponding duty, the Billy Rose panel applied the "extinguishment doctrine" attempting to distinguish Ferrer on the basis that "it involved the release of motion picture rights which could have been sold to any third person." On the basis of the foregoing discussion, the Commissioner cannot ascribe any such limitation to the Ferrer opinion. Rather, the Commissioner believes that Ferrer was wrongly decided to the extent that it holds that the only question for resolution in determining the tax treatment applicable on the disposition of a contract right is whether such contract right constituted a "capital asset." Respondent therefore contends that the extinguishment doctrine and the Ferrer test cannot be

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reconciled because they are predicated on two fundamentally different interpretations of what constitutes a transfer sufficient to constitute a sale or exchange within the meaning of Code § 1222.

In addition, one point relied on by the Second Circuit in Ferrer to support its interpretation is faulty. The Second Circuit viewed the enactment of Code § 1241 as an expression of Congress' disenchantment with the extinguishment doctrine generally. See Ferrer v. Commissioner, supra, at 131. However, the legislative history of that section makes it unequivocally clear that Congress had no such intention. Rather, Congress intended that Code § 1241 be strictly limited in its effect to cancellation payments paid to distributors with a substantial capital investment and to tenants for relinquishing their leaseholds. S. Rep. No. 1622, 83rd Cong., 2d Sess. 115 (1954).

- B. The \$125,000 payment received by petitioner was paid by CBS in liquidation of its contractual obligation to restore petitioner's property and not as payment for damages done to petitioner's property.

The Second Circuit proposes that at least part of the \$125,000 payment was for damages done to Sirbo's property and to treat this payment as ordinary income simply because the transaction was cast in the form of a payment for restoration is to exalt form over substance. The Commissioner submits that there is no merit to this suggestion.

A transaction must be taxed on the basis of what the parties did, not on the basis of what they might have done. Edward Bartsch, 18 T.C. 65 (1952), aff'd, 203 F.2d 715 (2nd Cir. 1953). This case does not present a situation where the parties have simply mis-labeled the transaction. Clearly, CBS received nothing for its payment other than the right to adapt Sirbo's property to its particular purposes. Stated otherwise, the payment by CBS was for the use of property, which is indistinguishable

from rent. CBS did not intend to acquire the property removed or damaged by the renovations and Sirbo had no intention of selling such property. Furthermore, petitioner has introduced no evidence that this property actually passed to CBS.

Even if what the parties did is disregarded, the substance of the transaction herein would not qualify as a "sale" under section 1231 no matter what label the parties might choose to give it. As both Courts determined, a payment for damage voluntarily permitted by the owner of property does not constitute an "involuntary conversion." Neither does it constitute a "sale" of the damaged property because nothing is transferred to the ostensible purchaser. Accordingly, the transaction is nothing more than a payment for the use of property.

Even if the transaction is viewed in the light most favorable to petitioner, it is clear that only a portion of the payment could be considered as payment for damage done to Sirbo's property. Without

question, removal of CBS's improvements would have constituted a considerable element in the restoration of the property and in no respect could a payment for this purpose be considered a "sale." Petitioner has produced no evidence or made any suggestion as to how the payment could be allocated.

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- C. There is no basis for the Second Circuit's suggestion that the term "sale" as used in section 453 was intended to have a more restrictive meaning than the term "sale" as used in section 1231.

In Billy Rose, the question was whether a transaction, in all material respects identical with the instant case, was a "sale or other disposition" for purposes of the installment sales provisions of section 453. The Billy Rose panel determined that the transaction was not a "sale," and, as the Second Circuit herein noted, this decision was in no way predicated on any limitation of the term "sale" in section 453.

Herein, the Second Circuit made the novel suggestion that the term "sale" as used in section 453 may have been intended by Congress to have a more limited meaning than the same term as it was used in section 1231. As support, the Court pointed to certain cases and to the legislative history of section 453 which point out that section 453 is to be interpreted strictly and that the section is

concerned with the timing of income, not with the characterization of income as ordinary or capital. The Commissioner agrees completely with the observation that section 453 is concerned with the timing of income rather than the characterization and that section is to be construed strictly. But he fails to see how this in any way indicates that the term "sale" was intended to have a more limited meaning in section 453 than in section 1231.

In defining "sale" as it appears generally throughout the Code, the Supreme Court in Commissioner v. Brown, supra, stated that:

A sale * * * is a common event in the nontax world; and since it is used in the Code without limiting definition and without legislative history indicating a contrary result, its common and ordinary meaning should at least be persuasive of its meaning * * * . Unquestionably the courts in interpreting a statute have some scope for adopting a restricted rather than literal or usual meaning of its words where acceptance of that meaning would lead to absurd results * * * or would thwart the obvious purpose of the statute * * * . (Emphasis added.)

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Applying these principles to section 453 reveals that the language of this section neither limits nor otherwise provides a definition of "sale." The legislative history of the section is likewise silent on the matter. See, S. Rept. No. 52, 69th Cong., 1st Sess. 19 (1926). And finally, the Commissioner is aware of nothing, and nothing has been pointed out by the Second Circuit, which would even remotely indicate that the term "sale" as used in section 453 must be given a more restrictive meaning than the same term as used in section 1231.

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- D. The capital gain v. ordinary income issue in Boston Fish Market was conceded by the Commissioner and not decided by Judge Raum. Thus there was no inconsistency between that decision and the decision herein which would require that taxpayer's petition for rehearing be granted.

The Second Circuit suggested that Judge Raum did not rely on the Commissioner's concession of the capital gains issue in Boston Fish Market, and, in fact, had decided the issue. As support for this view, the Court cited the underlined portion of the following excerpt from Judge Raum's opinion.

A cash payment, in liquidation of a lessee's obligation to make restorations to leased premises, suggests none of the difficulties posed by the Bruun case and sought to be remedied by the exclusionary provisions of section 22(b)(11) of the 1939 Code and section 109 of the 1954 Code. The income thus received is neither intrinsically part of the property in respect of which the payment is made as to create problems in ascertaining its value, nor is it so "fixed" an asset as to possibly place a burden on the lessor in raising the necessary funds to discharge a tax liability imposed upon the receipt. Indeed, in both instances, the opposite is true. Accordingly, both before and after the Bruun case and the responsive legislation thereto in the Revenue Act of 1942,

similar "cash" payments have generally been regarded as having been received in sale or exchange of the unrestored property.

Taken in context, there can be no doubt that Judge Raum was not deciding the issue of capital versus ordinary gain. With the Commissioner's concession in mind,² Judge Raum was merely holding that such "cash" payments are taxable rather than excludable under section 109. Furthermore, Judge Raum gave no indication whatsoever that he was not accepting the Commissioner's concession. The only logical conclusion that can be drawn from this fact is that the issue was no longer in the case and any comment with regard to the issue would simply be dicta.

For these reasons, this Court did not render inconsistent opinions and was therefore justified in rejecting Sirbo's petition for rehearing which was premised on this non-existent basis.

2. Judge Raum recognized the Commissioner's concession in footnote 2, 57 T.C. at 887, which reads as follows: "On brief the Commissioner no longer argues that the \$47,500 is taxable in full as ordinary income."

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CONCLUSION

In accordance with the foregoing, the Commissioner submits that this Court's prior decision herein was correctly predicated upon the Second Circuit's decision in Billy Rose's Diamond Horseshoe and such decision should accordingly be re-affirmed.

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UNITED STATES TAX COURT

SIRBO HOLDINGS, INC.,)	
)	
Petitioner,)	
)	
v.)	Docket No. 515-69
)	
COMMISSIONER OF INTERNAL REVENUE,)	
)	
Respondent.)	

PETITIONER'S BRIEF
IN REPLY TO
BRIEF FOR RESPONDENT ON REMAND

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ARGUMENT

I

THE COMMISSIONER HAS FAILED TO
EXPLAIN AND JUSTIFY THE DIFFERENT
POSITIONS TAKEN BY HIM IN THIS
CASE AND IN BOSTON FISH MARKET.

In vacating the Tax Court's decision and remanding "for further proceedings consistent with this opinion" the Court of Appeals for the Second Circuit stated in its opinion (476 F.2d 981, 989; footnote 10):

"The Tax Court should require the Commissioner to explain and justify the different positions taken by him in this case and in Boston Fish Market."
(Emphasis supplied.)

The Commissioner's BRIEF FOR RESPONDENT ON REMAND fails to "explain and justify" these different positions.

Indeed, the Commissioner seems to recognize that no adequate "explanation" or "justification" is possible, because after weakly reciting two "factors" allegedly relied upon by his representatives in the Boston Fish Market case, (Boston Fish Market Corporation, Fulham and Maloney, Inc., 57 T.C. 884 (1972)), he states (pp. 22, 23):

"Upon reconsideration in connection with the instant case, it has been determined that the foregoing factors do not provide a sufficient distinction between these two cases....

"Although the respondent has concluded that the distinguishing factors in Boston Fish Market are not sufficient to dictate a different result, it should be recognized that the decision of the respondent's representatives to concede the capital gains issue in that case was not unreasonable inasmuch as they were dealing with a case in which the facts, as indicated, are less favorable to the Commissioner than in the instant case."

Taxpayer in this case agrees that the Commissioner was reasonable in conceding the parallel issue in the Boston Fish Market case; taxpayer insists, however, that such reasonable conduct should be similarly extended to it, since the Commissioner is confessedly unable to articulate "a sufficient distinction between the two cases".

Indeed, the Commissioner's concession in Boston Fish Market was also considered reasonable by Judge Raum, who stated in that case (57 T.C. at page 989):

"Accordingly, both before and after the Bruun case and the responsive legislation thereto in the Revenue Act of 1942, similar 'cash' payments have generally been regarded as having been received in sale or exchange of the unrestored property." (Underscoring supplied.)

Judge Raum did not place emphasis on some facts or fact--peculiar to the Boston Fish Market record--that made the Commissioner's concession in that case especially reasonable. Rather he refers to "similar" payments being given capital gain treatment before as well as after the Revenue Act of 1942.

As pointed out above, the Commissioner's BRIEF FOR RESPONDENT ON REMAND has not adequately explained "the difference" between his treatment of the taxpayer in the Boston Fish Market case and the taxpayer in this case. It is no explanation for him to say now that he erred in making the unqualified concession reflected by the Boston Fish Market case. Counsel for the taxpayer in the instant case (and the Tax Court, and the Court of Appeals) have the right to know whether so unqualified and uncompensated a concession was based upon an understanding and application of the law generally prevailing within the Commissioner's office, of which other taxpayers (besides the taxpayer in Boston Fish Market) were also beneficiaries. If it is a sufficient "explanation" of disparate taxpayer treatment for the Commissioner merely to allege that he previously erred, then the Commissioner has really no duty of consistency to taxpayers because he can always argue--with facile and engaging modesty--that some prior concession of his to other taxpayers, no matter how unqualified, reflected merely

a previous error of interpretation.

Neither does the setting out of reasons in support of his present view of the law constitute an explanation. He must explain also his prior position as reflected by his Boston Fish Market concession, e.g., how long that prior view had obtained, the legal reasoning behind it, what prompted his recent abrupt change of views, including any intra-departmental memoranda bearing thereon, etc.

By filing a brief explaining only his position in the instant case, without furnishing any "explanation" or "justification" of his contrary recent position in the Boston Fish Market case, the Commissioner has made only a fifty per cent showing with respect to the direction of the Court of Appeals.

II

THE COMMISSIONER HAS A LEGAL DUTY TO TREAT SIMILARLY SITUATED TAX-PAYERS EQUALLY; IN THE ABSENCE OF AN ADEQUATE EXPLANATION OF HIS CONCESSION IN THE BOSTON FISH MARKET CASE, THAT DUTY WAS BREACHED HERE.

The Commissioner's BRIEF FOR RESPONDENT ON REMAND (page 17) starts with the argument that "the Commissioner breached

no duty of consistency to petitioner by virtue of his concession in Boston Fish Market." This reflects an inaccurate view of taxpayer's position here.

The taxpayer's position is not that the Commissioner breached a duty of consistency by making the concession reflected by the Boston Fish Market case; rather, it is taxpayer's position here that the Commissioner breached a duty of consistency in not extending a similar concession to it, since its similar case was then also contemporaneously pending before the Tax Court. Compare International Business Machines Corp. v. United States, 343 F.2d 914, 920-925 (Ct. Cl. 1965).

The Commissioner apparently regards equal treatment by him of similarly situated taxpayers as simply another good, administratively desirable "goal" (upon which the Commissioner says he "places the highest priority") but not something legally required. Thus he argues (brief, pp. 18, 19):

"Uniformity of treatment on a nationwide basis is obviously desirable and it is a goal upon which the Commissioner places the highest priority. Yet, when inconsistencies occur, as they must, no legal principle requires that the Commissioner compound the error by extending such erroneous treatment to other taxpayers. Petitioner can hardly claim to have been prejudiced or disadvantaged by the Commissioner's treatment of Boston Fish Market since it in no way relied on such treatment, and in fact, it was not aware of such treatment until after its own tax liability had been determined by the Court.

"Apart from the obvious danger of perpetuating errors, interpretation of the principle of equality of treatment as creating 'a duty of consistency' on the part of the Commissioner would present a potentially enormous administrative problem for both the Commissioner and the courts. As noted previously, the majority of unagreed cases are ultimately settled. Any number of valid reasons may exist for settlement or concession of an issue which is apparently the same as an issue in litigation, i.e., the issue may in fact not be the same due to the presence or absence of a particular factor, the issue may be conceded due to the lack of evidence or the issue may be identical and have been settled as a 'trade-off' for a more important issue."

But the Commissioner here does not cite a single one-- among his listed "number of [possible] valid reasons"--as applicable here to explain the difference between his treatment of the taxpayer in Boston Fish Market and his treatment of the instant taxpayer. There was apparently no "trade-off" for his unqualified concession in the former case; the Commissioner does not suggest that there was. The Second Circuit in its opinion in the instant case also pointed out that this is not a situation where the Commissioner had to take inconsistent litigating positions, in order to protect the revenue. 476 F.2d at page 988, footnote 7.

In summary, whatever exceptions the future may develop, with respect to the Commissioner's recognized legal duty to treat

similarly situated taxpayers equally, that duty was breached in this case in the absence of a full and adequate explanation from the Commissioner of his concession in the Boston Fish Market case, an explanation called for by the Court of Appeals in its opinion.

According equality of treatment to similarly situated taxpayers, to the fullest extent achievable, is a constitutional and legal imperative, one that will not evaporate simply because the Commissioner voices his fear of "a potentially enormous administrative problem for both the Commissioner and the courts". Article I, Section 8 of the Constitution mandates that "all duties, imposts and excises shall be uniform throughout the United States". In addition, Amendment V of the Constitution imposes a "due process of law" requirement upon federal action, which implies an "equal protection of the laws" or "prohibited unfairness" mandate necessitating nondiscriminatory treatment of similarly situated citizen-taxpayers. Cf. Bolling v. Sharpe, 347 U.S. 497 (1954).

In short, evenhanded treatment of taxpayers similarly situated is not just another administratively desirable "goal". As Mr. Justice Frankfurter put the matter in his concurring opinion in United States v. Kaiser, 363 U.S. 299, 308 (1960):

"The Commissioner cannot tax one and not tax another without some rational basis for the difference. And so, assuming the correctness of the principle of 'equality', it can be an independent ground of decision that the Commissioner has been inconsistent, without much concern for whether we should hold as an original matter that the position the Commissioner now seeks to sustain is wrong."

See also Mary Carter Paint Co. v. Federal Trade Commission, 333 F.2d 654 (C.A. 5, 1964), rev'd on other grounds 382 U.S. 46 (1965), and Columbia Broadcasting System, Inc. v. Federal Communications Commission, 454 F.2d 1018 (C.A. D.C., 1971).

III

A LESSEE'S PAYMENT MEASURED BY
THE REASONABLE COST OF RESTORING
LEASED PREMISES TO THEIR PRE-LEASE
CONDITION, CONSTITUTES FOR THE
LESSOR A RETURN OF CAPITAL, THAT IS,
PAYMENT FOR THE "SALE OR EXCHANGE"
OF THAT PART OF THE LEASED PREMISES
REMOVED OR DESTROYED BY THE LESSEE.¹

A lessee's payment measured by the reasonable cost of

¹Contrary to the Commissioner's statement at page 13 of his Brief for Respondent on Remand, the taxpayer did claim that the damage to its capital was essentially equivalent to a "sale or exchange". See the opening statement of taxpayer's counsel (R. 7, 8).

restoring leased premises to their pre-lease condition (reasonable wear and tear excepted), constitutes for the lessor a return of capital, that is, a payment for the "sale or exchange" of that part of the leased premises removed or destroyed by the lessee.

Vol. 3B Merten's, Law of Federal Income Taxation, §22.98

(Chapter 22, Page 721) states:

"Where a tenant was required to restore the premises at its own expense but obtained a release from this obligation on making a payment to the landlord, the payment was held to be a return of capital to the landlord, 'as such settlement constituted the sale or exchange of a capital asset'." Citing Hamilton & Main, Inc., 25 T.C. 878 (1956).

This principle was recognized in Commissioner v. Riss, 374 F.2d 161 (C.A. 8, 1967), where the Court stated, at pages 172, 173:

"No cases directly in point have been cited or found upon the precise issue before us. Cases relied upon by the taxpayer, such as Washington Fireproof Bldg. Co., 31 B.T.A. 824, Waggoner v. Commissioner, 15 T.C. 496, and Hamilton & Main, Inc. v. Commissioner, 25 T.C. 878, are all factually distinguishable. In those cases, damages above ordinary wear and tear had risen in connection with the use of the premises or alterations made thereto, and it was held that the reasonable cost of restoration of damage inflicted, required by the lease, was a return of capital."

VIII

THE CONCLUSION OF JUDGE QUEALY
THAT THE PAYMENT IN QUESTION
WAS FOR AN "UPDATING" OF THE
NEW LEASE AGREEMENT, IS NOT
INCONSISTENT WITH PETITIONER'S
RIGHT TO CAPITAL GAIN TREATMENT.

Judge Quealy in his opinion concluded that the \$125,000 payment was for "updating" the lease restoration clause in the new lease to January 1, 1964, the commencement date of such new lease. 57 T.C. at pp. 537, 538, 539. But "updating" the lease restoration clause in the new lease to January 1, 1964, is not inconsistent with Sirbo's asserted right to capital gain treatment, under Sec. 1231, for this \$125,000 payment made under the old leases. This is only another way of reflecting the fact that the \$125,000 payment to Sirbo was for the "sale or exchange" or voluntary "conversion" of that portion of its depreciable business premises that had occurred between 1947 and December 31, 1963.

Once CBS agreed to pay \$125,000 to Sirbo for what CBS had done to the leased premises between 1947 and December 31, 1963 under the old leases, an "updating" of the lease restoration clause, in the new lease commencing Jan. 1, 1964 (so to replace 1947 with January 1, 1964) became inevitable. Certainly neither Sirbo nor

CBS expected that CBS as lessee should pay twice for damage done to the leased premises between 1947 and December 31, 1963; that might have been the arguable consequence (which both parties wanted to avoid) if there were no "updating" of the lease restoration clause date in the new lease, to January 1, 1964.

Judge Quealy's opinion, moreover, states "the theatre was leased to CBS for use as a radio-and television-broadcasting studio" without also noting the primary reference to the lease of the premises "as a theatre". 57 T.C. 536. The November 14, 1947 lease⁵ (Ex. 2-B, page 3) provided:

"FIRST:- It is expressly understood and agreed that this leasehold is of a theatre as more particularly hereinbefore referred to, with such appurtenances thereto belonging and equipment therein now contained, which are owned by the LANDLORD,... The TENANT shall have the right to use the premises as a theatre, and for radio broadcasting and television purposes of its business, provided however, that the TENANT shall not exhibit in the said theatre, whether in connection with radio broadcasting or not, any performance which is immoral, indecent or obscene."

* * *

⁵Television was in its infancy at this date in 1947, a fact the Tax Court may and should judicially notice.

"THIRD:- The TENANT shall take good care of the demised premises and of all the plumbing, wiring, light fixtures, heating fixtures, glass and other fixtures, equipment or appurtenances thereto and shall make all repairs thereto and replacement thereof which may be necessary." (Emphasis supplied.)

* * *

In short, use of this theatre for a radio and/or television broadcasting studio represented permitted or possible uses only. Every lease thereafter between Sirbo and CBS repeated this language that "it is expressly understood and agreed that this leasehold is of a theatre" and that "the TENANT shall have the right to use the premises as a theatre, and for radio broadcasting and television purposes of its business...." (Ex. 3-C, page 3; Ex. 5-E; Ex. 7-G, pp. 2,3). It did not matter to Sirbo which of the three permitted uses (theatre, radio, or television), or combination thereof, the lessee, CBS, selected. In any event Sirbo was entitled to the same rent; and in any event Sirbo was entitled to have the premises restored to their November 14, 1947, condition. Of course Sirbo was willing to continue to rent the theatre to CBS for any one, or a combination, of these three permitted or possible uses, but only with the understanding expressed in each of these successive leases that CBS had a continuing

obligation to restore the property to its November 14, 1947 condition (or to pay Sirbo damages in lieu thereof).

It is inaccurate, and unfair⁶, for Judge Quealy's opinion to suggest that such changes may have "advantaged"⁷ Sirbo. If these changes "advantaged" Sirbo, the question arises why Sirbo would insist, repeatedly, on "disadvantaging" itself by inserting into its successive leases with CBS a requirement that CBS restore the New Yorker Theatre to its November 14, 1947 (pre-television) condition. If these changes "advantaged" Sirbo, the further question arises why CBS was willing to agree to undo these changes and restore the theatre to its November 14, 1947, condition; and later, in lieu thereof, agree to pay Sirbo the considerable sum of \$125,000.

The fact is Sirbo and CBS regarded the changes made by the latter for its convenience as damaging the property of Sirbo, therefore entitling Sirbo to compensation.

Indeed, the suggestion that Sirbo was "advantaged" by having its theatre turned into a television studio, loses all

⁶The taxpayer Sirbo had no notice from the deficiency notice or the Commissioner's pleadings, or the prior case law, that it had some burden of "showing" that it was not "advantaged" by the changes effected by its lessee for the lessee's own convenience.

⁷There was expert testimony that Sirbo was adversely affected by the CBS alterations. (R. 129, 130)

significance when it is noted that under the lease terms all of the radio and television equipment installed by CBS remained CBS's property, with an understanding that such could and would be removed from the lease premises on expiration or termination of the lease. The lease entered into on November 14, 1947, provided as follows (Ex. 2-B, pp. 5, 6):

"FOURTH:-At the expiration or other termination of the term hereby granted, the TENANT shall and will leave the said premises and the theatre whole and in good order and condition and will remove therefrom every and all its equipment, goods, and effects, and those of all persons claiming under it, and will deliver up the demised premises in as good order and conditions as reasonable wear and tear and damage by the elements will permit, it being understood that all scenery therein, stage hangings, properties, decorations and equipment, including but not limited to radio and/or audio equipment, and its associated equipment, installed and paid for by the TENANT, which may be affixed to or contained in the herein demised premises may be removed by the TENANT whether the same constitutes fixtures or not, provided, however, that the TENANT shall restore the premises substantially to the condition in which they exist at the time of the making of this lease, reasonable wear and tear and damage by the elements excepted, all in accordance with the requirements of the LANDLORD, and the TENANT shall fully indemnify the LANDLORD for every and all costs and expenses of whatsoever name or nature that may be required for the purposes of reinstating the premises to said condition which existed prior to the TENANT'S occupancy." (Emphasis supplied.)

Subsequent leases contain language to the same effect. (Ex. 3-C; Ex. 5-E; Ex. 7-G)

In addition, the following language in the subsequent leases demonstrates clearly that neither Sirbo nor CBS regarded the structural alterations initiated by CBS after November 14, 1947, as benefiting Sirbo (Ex. 3-C; Ex. 5-E):

"TENANT agrees to restore any and all seats heretofore removed by TENANT, to remove the control booths installed by TENANT and to remove the extension of the stage apron installed by TENANT."

CONCLUSION

For the foregoing reasons, petitioner is entitled to long-term capital gain treatment for the element of gain in the \$125,000 payment.

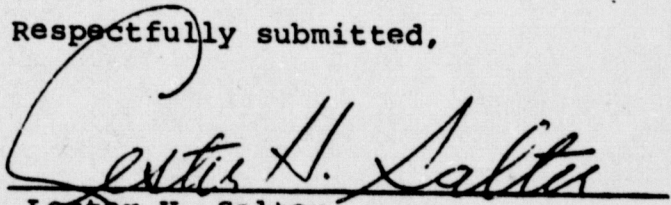
Once this Court resolves the question as to the nature of the gain, it must determine the amount of the gain. See footnote 9 of the opinion of the Court of Appeals indicating that an allocation of basis is required. Petitioner introduced extensive evidence at the trial showing that the amount of \$41,066.74, was the proper amount of basis allocable to the New Yorker Theatre.⁸

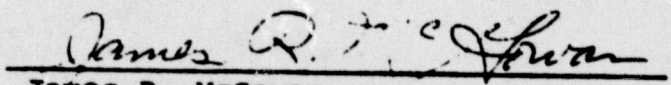
⁸Judge Quealy's remark (57 T.C. 537, 538) that "much of the property removed from the theatre" would have been "fully depreciated" before the \$125,000 was negotiated, is not only not supported by this record, but is legally irrelevant to the right to capital gain treatment under Section 1231. See Reg. 1.1231-1(c)(1).

See paragraphs numbered 7 through 11 of petitioner's Statement of the Facts at pages 4 and 5 of its original brief filed in this Court.

Alternatively, this Court may under the remand leave the question of allocation of basis to possible agreement by the parties.

Respectfully submitted,


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James R. McGowan

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(401) 274-0300

January 25, 1974

61 T. C. No. 77

UNITED STATES TAX COURT

SIRBO HOLDINGS, INC., Petitioner v. COMMISSIONER OF
INTERNAL REVENUE, Respondent

Docket No. 515-69.

Filed March 13, 1974.

The petitioner leased its property for use as a theater or broadcast studio pursuant to a lease whereby the lessee was obligated to restore the property to its original condition, reasonable wear and tear excepted. In the negotiations for a new lease, the lessee paid the petitioner \$125,000 for "updating" the restoration clause. Held: The payment in question did not constitute an amount received on account of a sale or exchange or a compulsory or involuntary conversion of property within the meaning of sec. 1231, I.R.C. 1954.

Lester H. Salter, for the petitioner.

Marwin A. Batt and Marion L. Weston, for the respondent.

SERIALIZED MAR 13 1974

Rec'd 3/15/74

[2 -]

SUPPLEMENTAL OPINION

QUEALY, Judge: In our Opinion entered January 27, 1972 (57 T.C. 530), on the basis of the facts in this case we held that the sum of \$125,000 received by the petitioner in consideration for the "updating" of the restoration clause in a lease did not constitute an amount realized either from the sale or exchange of property or from the compulsory or involuntary conversion of property within the meaning of section 1231.¹ On appeal, the U.S. Court of Appeals for the Second Circuit remanded the case for reconsideration of our decision. 476 F. 2d 981 (Decided March 23, 1973).

The appellate court agreed with our holding that there was no compulsory or involuntary conversion of property. However, that court remanded the case for reconsideration of our decision that the payment did not constitute an amount realized from the sale or exchange of property used in the trade or business

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All statutory references are to the Internal Revenue Code of 1954, as amended.

[3]

within the meaning of section 1231. Insofar as material herein, section 1231 provides as follows:

SEC. 1231. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.

(a) General Rule.--If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. * * *

It will be noted that the statute, by its very terms, recognizes that there may be a distinction between "a sale or exchange" of property and "the compulsory or involuntary conversion" of property. This distinction stems in part from the decision of the Supreme Court in Helvering v. Flaccus Leather Co., 313 U.S. 247 (1941). See also, Brown v. Commissioner, 380 U.S. 563, 571 (1965); Chicago, Burlington & Quincy R. Co. v. United States, 455 F. 2d 993 (Ct. Cl. 1972), pp. 1002-1004.

[4 -]

In Helvering v. Flaccus Leather Co., supra, the taxpayer's plant was destroyed by fire. As a consequence, the taxpayer received payment from its insurer for the loss of its buildings, machinery and equipment. The property had been fully depreciated. The taxpayer contended that the insurance proceeds should be treated as a gain from the sale or exchange of its property. In denying such claim, the Supreme Court said:

Generally speaking, the language in the Revenue Act, just as in any statute, is to be given its ordinary meaning, and the words "sale" and "exchange" are not to be read any differently. Compare Helvering v. Hammel, 311 U.S. 504; Fairbanks v. United States, 306 U.S. 436; Burnet v. Harmel, 287 U.S. 103. Neither term is appropriate to characterize the demolition of property and subsequent compensation for its loss by an insurance company. Plainly that pair of events was not a sale. Nor can they be regarded as an exchange, for "exchange," as used in § 117(d), implies reciprocal transfers of capital assets, not a single transfer to compensate for the destruction of the transferee's asset.
[p. 249]

The Congress thereupon enacted section 117(j) of the Revenue Act of 1942, wherein it was specifically provided that gain realized as a result of the compulsory

[- 5 -]

or involuntary conversion of property shall be treated the same as a gain from the sale or exchange of such property.²

The amendment in question merely modified the decision in the Flaccus case as applied to a payment received as a result of the compulsory or involuntary conversion of property where the payor received nothing in exchange. In all other cases, the requirement that there be a "sale or exchange", as defined in the Flaccus case, remained unchanged.

We find no justification in the absence of Congressional action to disregard the tests established in Flaccus Leather Co., supra, in the characterization

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In explanation thereof, the report of the Committee on Finance states:

Section 117(j), as added to the Internal Revenue Code by subsection (b) of this section, provides special treatment for the gains and losses upon the sale or exchange of depreciable property and of land, held for more than 6 months, and for the gains and losses upon the compulsory or involuntary conversion of such depreciable property and land and of capital assets held for more than 6 months. [S. Rept. No. 1631, 77th Cong., 2d Sess., p. 120 (1942).]

[6 -]

of the transaction between the petitioner and its lessee. Measured by those standards, there was no sale or exchange of any property or property right by the petitioner.

The determination of the rentals for an additional term and the determination of the amount to be paid for updating the restoration clause were but steps in a single negotiation relating to the terms upon which the lessee would continue to occupy the property. As a result, the petitioner received a "premium" in the form of a payment for updating the restoration clause and the lessee was given a new lease upon terms more favorable with respect to restoration than its prior lease.

The liability of the lessee encompassed not only the replacement of curtains, seats, and the like, which had long since been removed and presumably "junked," but also the removal of the walls, partitions, and other installations made by the lessee to convert the property to its use. To the extent that the obligation to restore related to the seats, carpets, curtains, and other property which had been removed by the lessee in

[7 -]

the conversion of the theater, we are dealing with depreciable assets, the cost of which had long since been recovered by the petitioner through the composite depreciation claimed on the property as a whole. To the extent that the obligation related to the cost of removing walls, partitions, and wiring installed by the lessee, it was incumbent upon the petitioner to show that the modifications damaged its property in the economic sense. At this time there could be no proof of any damage or economic loss on account of the changes made by the lessee. As evidenced by the new lease, the value of the property was, if anything, enhanced.³

Washington Fireproof Building Co., 31 B.T.A. 824 (1934), and Boston Fish Market Corp., 57 T.C. 884 (1972), both involved situations wherein the lessee surrendered possession of the property and, in lieu of its obligation

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Where a payment represents compensation for measurable damages to the property, this Court has held that the amount received should be charged initially to the taxpayer's basis and only the excess is taxable. Pioneer Real Estate Co., 47 B.T.A. 886 (1942). However, Sirbo Holdings did not offer proof that it sustained any economic damage to its property which would bring it within that rule.

[8 -]

for restoration, paid an agreed amount in liquidated damages. In the former, the taxpayer reported the excess of the amount received over the estimated cost of restoration as ordinary income. In the latter case, the Commissioner did not challenge the taxpayer's right to report the amount received as a return of capital. Neither case presented for decision the question whether a payment such as that involved in Sirbo Holdings, Inc., constitutes an amount received from the sale or exchange of property within the meaning of section 1231.⁴

Notwithstanding the opinion of the appellate court remanding this case to us for consideration,

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In explaining the apparent inconsistency of his position in the Boston Fish Market case with his position in the Sirbo Holdings case, the respondent states that his concession in the former was in error. Without such concession, the Boston Fish Market case may well have been decided differently. The cases cited by this Court in the Boston Fish Market case at p. 889, which were adverted to by the Court of Appeals (476 F. 2d at 988), were mentioned only for the purpose of showing that any amount received in excess of basis constituted taxable income, and the reference to "sale or exchange" was made solely in that context. This Court did not undertake to make any determination as to whether the excess over basis constituted long-term capital gain as against ordinary income.

[9 -]

we must profess our inability to distinguish in principle between our opinion in this case and the opinion of the appellate court in Billy Rose's Diamond Horseshoe, Inc. v. United States, 448 F. 2d 549 (C.A. 2, 1971), with which we are in full agreement. The term "sale or other disposition" in section 453 encompasses both the "sale or exchange" and the "compulsory or involuntary conversion" in section 1231. A transaction which was not a "sale or other disposition" under section 453, a fortiori, would not constitute a "sale or exchange" under section 1231.

Nor do we find the decision in Billy Rose's Diamond Horseshoe incompatible with that of the appellate court in Commissioner v. Ferrer, 304 F. 2d 125 (C.A. 2, 1962). In Ferrer, the court was dealing with the rights of a licensee under the copyright laws. As in the case of patents, when a licensee's rights are extinguished, those rights revert by operation of law to the licensor or owner of the copyright or patent. Cf. United States v. Dresser Industries, Inc., 324 F. 2d 56 (C.A. 5, 1963). It

UNITED STATES TAX COURT
WASHINGTON

SIBBO HOLDINGS, INC.

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. **315-69.**

DECISION

Pursuant to the determination of the Court as set forth in its Supplemental Opinion filed on March 13, 1974, it is

ORDERED AND DECIDED: That there is a deficiency in income tax due from the petitioner for the taxable year ended June 30, 1964, in the amount of \$52,373.30.

(signed) William H. Quealy

Judge

Enter: ENTERED MAR 15 1974

UNITED STATES TAX COURT

WASHINGTON, D. C.

SIRBO HOLDINGS, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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DOCKET No. 515-69

Notice of Appeal

Notice is hereby given that Sirbo Holdings, Inc.
hereby appeals to the United States Court of Appeals for the
Second Circuit from the decision of this court entered in the
above-captioned proceeding on the 15th day of March, 1974.

(Signed) Lester H. Salter

Lester H. Salter

(SIGNED) JAMES R. MCGOWAN

James R. McGowan
SALTER, MCGOWAN, ARCARO & SWARTZ
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